THE THEORY OF THE FOREIGN EXCHANGES

BY

THE RIGHT HON. VISCOUNT GOSCHEN

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PREFACE TO THE PRESENT EDITION

THE present new edition of Viscount Goschen's work, *The Theory of the Foreign Exchanges,* comes at a time when the world's attention is absorbed by the vast conversion scheme in respect of the British War Loan. As a consequence there will be eagerness on the part of economists and students of finance generally to refresh their reading of this classic of financial exposition.

It has been deemed advisable in this edition to refrain from altering a single word of the text as Lord Goschen last revised it. The broad principles which he enunciated remain; his illustrations are now matters of history—but they gain value both by their very detachment from the fluidity of current conditions in the exchanges and by directing the reader to comparisons with past experiences.

By some, perhaps, Lord Goschen's style may have been considered heavy. This impression is partly due to the fact that he allowed his discussion of a particular point frequently to run to several pages without providing a natural rest at which to assimilate the progressive stages

of argument. Opportunity has, therefore, been taken to facilitate reading by breaking many of the original lengthy paragraphs.

Few men have left a greater mark on English monetary history than George Joachim Goschen. The son of a London merchant of German extraction, he was born in 1831. From Rugby he went up to Oriel College, Oxford, where he took a first-class in classics. He entered his father's firm of Frühling and Göschen, of Austin Friars, in 1853, and in 1856—at the early age of 25—he became a director of the Bank of England.

Doubtless the failure of Mr. Gladstone's only attempt at the conversion of the National Debt in 1853, the train of events leading up to and immediately following the Crimean War, and affairs on the North American Continent, in combination, impelled the young financier to analyse the principles underlying the courses of the money market and to put the result into the form of a treatise. So 1861 saw the first edition of *The Theory of the Foreign Exchanges*—a work that at once attracted wide attention. Its authoritativeness was further enhanced when two years later a revised edition was issued incorporating consideration of the American monetary situation, which as a result of the Civil War had been subject latterly to extraordinary fluctuations. A third edition followed

in 1864, containing other modifications of the illustrations; but after this Mr. Goschen preferred to retain the text without further alteration. Upon the wisdom of this decision there can be no question.

It is unnecessary here to discuss in too great detail the Author's entry into the political field and subsequent activities in public life. He was elected without opposition as Member for the City of London in 1865, in the Liberal interest. In November the same year he was appointed Vice-President of the Board of Trade and Paymaster-General, and in the following January was made Chancellor of the Duchy of Lancaster, with a seat in the Cabinet. When in December, 1868, Mr. Gladstone became Prime Minister, Mr. Goschen joined the Cabinet as President of the Poor Law Board, from which office he passed in 1871 to the Admiralty, succeeding Mr. Childers as First Lord. In 1874 he was elected Lord Rector of the University of Aberdeen. As delegate for the British holders of Egyptian bonds, he was sent to Cairo in 1876, in order to arrange for the conversion of the debt, and succeeded in effecting an agreement with the Khedive.

Mr. Goschen's independence of spirit early became apparent when, in 1878, not feeling that he could vote uniformly with his party upon a

county franchise question, he retired from the City of London representation; he at once gained election at Ripon, where he continued until 1885. He was then returned for the Eastern Division of Edinburgh. He did not join the 1880 Gladstone administration, being opposed to the extension of the franchise, and after declining the Vice-royalty of India, accepted a special ambassadorship to the Porte, during which period (1880–1881) he settled the Montenegrin and Greek frontier questions. In 1884 he declined the Speakership of the House of Commons. His unceasing differences with Mr. Gladstone's policies caused him to break away, becoming one of the new Liberal Unionist party; and this step led in 1886, with Lord Salisbury in power, to the offer and his acceptance of the office of Chancellor of the Exchequer.

Mr. Goschen's Chancellorship during the Ministry of 1886–1892 was rendered memorable by his successful conversion of the National Debt in 1886—the most important of all the conversions of the British debt up to that time, a sum of £558,000,000 being involved. In the result, is was only necessary to find cash for paying off dissentients to the amount of £19,000,000, the final outcome of the operation being a saving in the annual interest charge of £1,412,000, increasing to twice that amount after fourteen years.

With that scheme, the new $2\frac{3}{4}$ per cent Consols became known as "Goschens."

Aberdeen University again conferred upon him the Lord Rectorship in 1888, and Edinburgh similarly honoured him in 1890. After an active period in the Unionist opposition of 1893 to 1895, Mr. Goschen returned to office as First Lord of the Admiralty. There he performed his greatest achievement for his country—the building up of the Two-Power Standard of the Navy, but for which England would have assuredly been defeated in the Great War. He retired from political life in 1900, with a peerage as Viscount Goschen of Hawkhurst. He did not, however, remain silent on the political questions of the day, and his opposition to Mr. Joseph Chamberlain's Tariff Reform campaign was largely responsible for the delay in the adoption of Protection by England for nearly thirty years.

During his retirement as an epitaph to his ancestor Lord Goschen wrote *The Life and Times of Georg Joachim Goschen, publisher and printer of Leipzig*. This was published in 1903. He died in 1907.

In the years that lie immediately ahead, when understanding of the exchanges will be more essential to the general body of the people of this and other countries, particularly those

within the British Commonwealth, than, perhaps, at any other period of our history, *The Theory of the Foreign Exchanges* may well prove to provide useful instructional material for the new generation that is arising.

B. F. HOPPER

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PREFACE TO THE THIRD EDITION

The few weeks which have elapsed since the publication of the second edition have again proved the rapidity with which the situation of the "Foreign Exchanges" may be reversed, and the difficulty of selecting durable illustrations.

In the preface to the second edition, allusion was made to the fact that the Russian Exchange, so long an example of unlimited fluctuations, had been brought almost to par. Since then a severe fall has again taken place. So, in the former edition, the rapid fall in the price of gold in America furnished the opportunity for comment and examination. But there also a turn has taken place, and to-day it would be necessary rather to seek an explanation of the rise than of the fall.

It is scarcely the province of a theoretical treatise to keep pace with each new combination of facts. An author may be considered bound to watch the progress of events, as a constant test of the accuracy of his principles, but it is hardly possible, nor is it necessary, perpetually to adopt new illustrations. It has, therefore, been deemed unnecessary to make any further alterations in the present edition.

G. J. GOSCHEN

London; 1864.

PREFACE TO THE SECOND EDITION

The history of the Foreign Exchanges for the last two years is a history of revolutions.

The movements which have occurred in many quarters have been almost unexampled in rapidity and extent. Countries which formerly supplied illustrations of particular phenomena in the Foreign Exchanges, may now be cited as instances of perfectly opposite combinations.

The various causes which have been stated in the following work as determining the course of the Foreign Exchanges have been at work with more than usual intensity, and the new combinations which events have presented have afforded many opportunities of testing the correctness and sufficiency of the principles advanced.

The exchanges of those countries which, two years ago, were selected as exemplifying the results of a depreciated currency or excessive indebtedness, might now, on the contrary, be cited as instances of rapid recovery. The Austrian Exchange has recovered fully 30 per cent. The Russian rouble has approached the par value, of gold. In America, on the other hand, the very

opposite has occurred. The American Exchanges, which in the former edition were shown to move within certain limits—determined by the cost of bullion shipments and by the intermediate value of money—have since afforded the most notorious examples in recent days of unlimited and indeterminable fluctuation.

An inquiry into the theory of the Foreign Exchanges can scarcely keep pace with the tide of events. However interesting a review of the events themselves might have been, it could not conveniently be introduced into a treatise which aimed chiefly at the statement of a theory, and dealt with contemporary fact only as illustrating general causes.

The new matter which, in this respect, has been introduced into the second edition, is confined to the consideration of the American Exchanges. It would not have been compatible with the general course of the argument to treat so complicated a question exhaustively or historically. The monetary situation of America has been so extraordinary, the difficulty of acquiring accurate knowledge on it is so great, the changes to which it is subject are so rapid, than an exhaustive inquiry into the actual facts would have assumed the proportions of a separate work. Thus any controversy which may arise on that portion of the present treatise

which deals with the American Exchanges, should turn rather on the correctness of the mode of interpretation on a common ground of fact, than on the absolute correctness of the facts themselves. The latter have been stated as carefully as possible, and every precaution against error has been taken. If, nevertheless, any uncertainty should be felt with regard to the description of particular circumstances, it must not be allowed to place in doubt the scientific certainty of the theory itself.

The other important alterations which have been made in the second edition are to be found in those chapters which discuss the question of so-called "Unfavourable Exchanges," and the "Adverse Balance of Trade," and which examine the possibility of "correcting" such a situation by means of a high rate of interest. With regard to the exact force of the term "Unfavourable Exchanges" and "Adverse Balance of Trade," as they are still used in monetary treatises, not as characterising any situation which from the general point of view of the prosperity of any country is really unfavourable, but simply as denoting a certain set of circumstances which bankers and merchants persist in calling by that name, the original text scarcely left room for much misconception.

Nevertheless the endeavour has now been

made to limit and define the sense of these terms still more rigorously, as it is highly important that a real discrepancy should not be supposed to exist between political economists and the banking world, whereas the discrepancy, if it exists at all, lies only in the nomenclature and not in the theory.

With regard to the power of a high rate of interest to affect the exchanges, the objection has been raised against certain passages in the first edition, that they seemed to countenance the idea that money might artificially be made cheaper or dearer, and that the action of banks or individuals might accomplish that which must really be determined by supply and demand. Possibly the expressions employed may have lent a colour to this objection, and, at all events, it seemed desirable to develop their meaning more fully.

It is hoped that the alterations introduced will clear up any misconception in this respect, and that it appears from the observations made as to the limits within which the influence of the Bank of England in dealing with the rate of discount is confined, that no exaggerated ideas of its powers were intended to be conveyed.

G. J. GOSCHEN

LONDON; 1863.

CONTENTS

CHAP.		PAGE
	PREFACE TO PRESENT EDITION . .	v
	PREFACE TO THIRD EDITION . .	xi
	PREFACE TO SECOND EDITION . .	xiii
	INTRODUCTION	xix
I.	DEFINITION AND PRELIMINARY EXAMINATION OF THE TRANSACTIONS WITH WHICH THE FOREIGN EXCHANGES ARE CONCERNED	1
II.	ANALYSIS OF INTERNATIONAL INDEBTEDNESS CONSIDERED AS THE BASIS OF THE FOREIGN EXCHANGES . .	11
III.	EXAMINATION OF THE VARIOUS CLASSES OF FOREIGN BILLS IN WHICH INTERNATIONAL INDEBTEDNESS IS ULTIMATELY EMBODIED . . .	22
IV.	ENUMERATION OF THE VARIOUS ELEMENTS OF VALUE WHICH DETERMINE THE FLUCTUATIONS IN THE PRICES OF FOREIGN BILLS . . .	42
V.	REMARKS ON THE INTERPRETATION OF THE FOREIGN EXCHANGES . .	82
VI.	REVIEW OF THE SO-CALLED CORRECTIVES OF THE FOREIGN EXCHANGES . .	123

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INTRODUCTION

THE inquiry which is conducted in the following pages belongs to that class of discussions for which, owing to the prevalent belief that they are peculiarly abstruse and technical, it is difficult, in ordinary times, to obtain a hearing. The moment must be seized for the ventilation of such subjects, when peculiar combinations of circumstances bring them into prominent and exceptional notice, and when they are exhibited as influencing or explaining events which are of universal interest and importance.

To those who make the Foreign Exchanges their constant study, and examine them not only in the light in which they present themselves to the political economist, as an index of the balance of trade between different countries, but also from the point of view from which they are regarded by bankers and merchants, as a reliable barometer of the state of the money-market, of the soundness of credit, of the rate of interest, and of the comparative position of the circulation in different countries, all monetary phases and mercantile incidents furnish an opportunity for correcting their theories by the test of facts.

But comparatively few, even of leading bankers and merchants, with the exception of those who are exclusively or mainly engaged in international transactions, are as conversant with the subject as its immense importance deserves; and it is thought that the present situation of monetary affairs, in which the Foreign Exchanges are exercising an abnormal and extraordinary influence, affords a peculiarly suitable opportunity for a discussion which otherwise might be considered uninviting and superfluous.

The object proposed is by no means to propound any dogmatic theories, but rather to call attention to many facts which are commonly believed to be peculiarly complicated and unintelligible, which, however, if carefully analysed and illustrated, may be presented in a simple form, and under such an aspect as to command general assent.

If the present treatise should in any way contribute towards producing a better and clearer understanding of many principles, the true appreciation of which is absolutely indispensable for the formation of just and comprehensive views as to the laws which govern our money-market and our foreign commerce, it will have attained its end.

In the treatment of the subject, the main difficulty has been to decide what degree of

acquaintance with the matters discussed the readers of the present essay might be presupposed to possess; and, further, from what point of view they might have been accustomed to regard it.

The inquiry may be conducted on several distinct principles according to the class of readers who are likely to interest themselves in the investigation, and thus it is not easy to adopt a mode which shall be equally satisfactory to all. If addressed to those who have studied the subject theoretically themselves, much may be taken for granted, the exposition of which would be tedious and unnecessary, and would only serve to encumber the examination of the more interesting problems and theories; while, on the other hand, if the general public is to share in the discussion, it seems necessary to adopt the opposite plan, and to presume that as yet the first axioms and leading features of the subject are but vaguely and inaccurately understood. Under this supposition, it would be desirable to proceed as systematically and completely as possible, even at the risk of enumerating or illustrating much which, in the opinion of some, might be passed over in silence.

A third and distinct course might be most suitable for those who, on the one hand, have ample practical acquaintance with the Foreign

Exchanges, and accordingly may be addressed as persons conversant with the subject; but, who, on the other hand, have not in any way systematised their experiences or drawn any conclusions from the facts which they have observed.

The Foreign Exchanges should be an object of interest as well to the political economist as to the general reader, but they will mainly fix the attention of the mercantile part of the community, who, consciously or unconsciously, are always under their influence. It is to this class that the present essay—which attempts to exhibit the relations of the Foreign Exchanges to our own money-market, as well as generally to international transactions, and to bring into clearer relief some of the hazy and indefinite notions which surround the subject—is primarily and mainly addressed.

But while in this sense the inquiry is conducted from a mercantile point of view with the special desire of throwing light upon mercantile questions, the author has attempted to be sufficiently precise in his arguments as not to offend the scientific theorist, and sufficiently diffuse in his illustrations and explanations, as to make himself understood by the general and uninitiated reader. His only qualification for the undertaking is to be found in his having daily

opportunities of studying many various forms of international transactions, and of practically feeling the effect of each different phase of the Foreign Exchanges. Without such opportunities it is exceedingly difficult to correct and test the various opinions which may be theoretically formed ; but even with their aid the author is conscious that he may prove unequal to his task. His motive for undertaking it is to be found in his conviction that the subject urgently requires ventilation, and his hope that even an imperfect attempt in this direction may lead to further and more able investigation.

THE THEORY OF THE FOREIGN EXCHANGES

CHAPTER I

DEFINITION AND PRELIMINARY EXAMINATION OF THE TRANSACTIONS WITH WHICH THE FOREIGN EXCHANGES ARE CONCERNED

In order to clear the ground for the consideration of the more interesting theories connected with the Foreign Exchanges, it is desirable in the first instance to define as clearly as possible the general meaning of the term.

The phrase "Foreign Exchanges" is in itself vague and ambiguous, being more frequently used to express the rate at which the exchanges in question are effected than the exchanges themselves—the prices rather than the transactions. When it is said in technical phraseology that the exchanges are rising or falling, or that the exchanges are at specie point, allusion is made to the fluctuations in the terms on which bargains are made between buyers and sellers of Foreign Bills.

SUBJECT MATTER OF THE EXCHANGE

However, before we treat the subject in this sense of the phrase—that is to say, as denoting

the rates at which exchanges take place—it is necessary to examine the subject-matter of the exchange itself, and to realize distinctly what it is that is bought or sold, transferred or given in exchange. When the transaction takes a practical form, Foreign Bills—that is to say, bills on foreign countries—constitute this subject matter; but a less technical explanation can be given. That which forms the subject of exchange is a debt owing by a foreigner and payable in his own country, which is transferred by the creditor or claimant for a certain sum of money to a third person, who desires to receive money in that foreign country, probably in order to assign it over to a fourth person in the same place, to whom he in his turn may be indebted. The operation which takes place is put very clearly by Mr. Mill in the following passage:—

"A merchant in England, A, has exported English commodities, consigning them to his correspondent B in France. Another merchant in France, C, has exported French commodities, suppose of equivalent value, to a merchant D in England. It is evidently unnecessary that B in France should send money to A in England, and that D in England should send an equal sum of money to C in France. The one debt may be applied to the payment of the other, and the double cost and risk of carriage be thus saved.

A draws a Bill on B for the amount which B owes to him; D, having an equal amount to pay in France, buys this bill from A and sends it to C, who, at the expiration of the number of days which the bills has to run, presents it to B for payment. Thus the debt due from France to England, and the debt due from England to France, are both paid without sending an ounce of gold or silver from one country to the other."*

This explanation, however, involves the idea of the transaction being carried out by the instrumentality of an actual bill of exchange, which, at the present stage of inquiry, it is better to ignore altogether. It will be found more convenient to treat the transaction, in the first instance, as a simple exchange of debts and claims, without considering the instruments by which it is accomplished. In its most general form, the case may be stated as follows:—

As the result of international commerce, a certain portion of the community, has become indebted to merchants in foreign countries; and in order to save the trouble, risk, and expense of sending coin, it seeks out another portion of the community to whom a similar amount is owing by the identical foreign countries in question, and buying up these debts, assigns them over in

* *Principles of Political Economy*, Chap. XX, par. 2.

payment to its own foreign creditors. And if the aggregate sums owing by any two countries to each other were absolutely equal—that is to say, equal in amount, coincident as to the period for fixed settlement, and payable, too, in an equal or identical currency—there would be no difficulty of any kind in determining the equivalent which the purchasers of such claims would pay to the sellers. It would simply be a sum equal to, or rather identical with, that which is payable abroad under the transferred claims. The amount required by the purchasers being equal to the amount held by the sellers, and required, too, at the same time, there would be no cause in operation to vary the price, and there would be no fluctuations in the rates of Foreign Exchanges. In technical language they would always remain at par.

INEQUALITIES IN INDEBTEDNESS

But, conversely, we arrive at the point which forms the essence of the present discussion: the fluctuations which actually take place in the Foreign Exchanges are at once the necessary result and the certain index of the inequalities which exist in the indebtedness of different countries, inequalities either in the amount of their liabilities or in the time within which payment must be made or in the relation

of the currency of one country to that of another.

It might have seemed easier to have explained the exchanges in question as exchanges between different currencies, as of sovereigns against francs, or of florins against dollars; the more so as practically this is the shape which actual transactions generally assume. But if the definition has been thus limited, a most important, and indeed essential feature, would have been overlooked; that is to say, that though one system of coinage were adopted for all countries, claims on foreign countries would nevertheless vary in price, and would still be either at a premium or at a discount, according as there happened to be at any moment a greater or less demand on the part of such as desired to transmit funds abroad as compared with the supply offered by such as had outstandings abroad which they were entitled to draw in.

For this is the first cause of what is generally spoken of as the rise and fall of Foreign Exchanges.

On some particular day, or through a given season, a large amount is required to be sent abroad in payment of debts; England, let us say, is heavily indebted to France, and the time has arrived for payment. At this time, however,

it happens that in the opposite branch of trade, that which results in France being indebted to England, fewer transactions have taken place, and thus there are comparatively few who have amounts standing to their credit in Paris which they might transfer to those who have to remit; in other words, adopting the language of merchants, there are few who have bills upon France.

The consequence is, that there is great competition for these few bills; those who do not bid high enough for them will either have to go through all the trouble of packing, insuring, and dispatching gold, or else will not punctually meet their engagements. Thus those who have the bills to sell are able to obtain more than the actual par value for them. In consideration of their having a given sum already at a spot where it is required by another, and whither the latter must convey it himself at some expense if they do not cede it to him, they are able to secure for themselves the whole of the benefit, which, if the exchanges were at par (that is to say, if the indebtedness of the two countries were equal), would be divided between the buyer and the seller. Instead of the arrangement being a mutual convenience, the seller is able, by the competition of the buyers, to secure the whole convenience to himself.

SUPPLY AND DEMAND

Supply and demand, in their usual form, determine the transaction at this stage. Bills on France, in the case just put, would be at a premium. In the opposite case, if there were more persons who had money to claim from France than those who required to send funds thither, bills on France would be at a discount.

These are the first and most elementary instances of fluctuations in the Foreign Exchanges; and for the purpose of appreciating clearly what is their real nature and origin, it is important to discard in the first instance all the accessory circumstances, and to hold fast to the general principle that what is really given in exchange in the natural and simple transactions from which all others are derived, is a sum of money at one place for an equivalent sum of money at another.

OTHER CONSIDERATIONS

By way of anticipation it might, however, be stated here that, in contradistinction to this simplest transaction, the most complicated would be one in which the sum of money given would be payable immediately, the equivalent recoverable three months later; the sum given be in gold, the equivalent in silver; the sum given be perfectly undoubted, being paid down

at once, the equivalent be of doubtful character, because involving a lengthened credit. To establish the equality between the two sums, it would accordingly be necessary to take into account the relative value at the time of gold to silver, the amount of interest which would be lost by waiting three months, and the amount of risk which would be run by receiving a piece of paper representing a promise to pay three months hence in exchange for cash paid down.

These are all considerations which affect the exchanges, and which indeed render the subject so complicated that the ground-work may easily be lost sight of.

Discussions are sometimes held on the state of the Foreign Exchanges in which attention is paid mainly to the value of money in different countries, to the amount of bullion held by each, and to the relative position of their paper currency—points, no doubt, of the highest moment in influencing the fluctuations in the exchanges, but nevertheless subordinate to the question of relative indebtedness, which remains the first and most material element.

PLAN OF STUDY

In studying the subject as a whole, it is above all things necessary to form a clear view of what is meant by international indebtedness, of the

elements of which it is constituted, and the various phenomena which it presents.

As soon as this elementary question, which underlies the whole theory of the Foreign Exchanges, is properly understood, and an idea has been gained of the various modes in which countries become indebted to one another, we can proceed to consider the form which this indebtedness assumes when the time of settlement arrives and when the floating debt is fixed in bills of exchange.

The course of the discussion will then naturally lead to the nature and form of these bills of exchange, to their purchase and sale, to the various influences which determine their price, to their frequent fluctuations, to the meaning and force of the usual phrase that the Foreign Exchanges are favourable or adverse, and to the value of the state of the exchanges as an index of international transactions.

We shall first consider the debts themselves, and shall find them finally represented by, and embodied in, a constant mass of bills of exchange; it will then be necessary to inquire whether these bills are payable at once, or at fixed future terms, whether they represent a final transaction or whether a portion only of a commercial operation, and how the rate of interest, the credit of the debtors, the indulgence

of the creditor, the depreciation of the currency in which the bills are payable, affect their exchangeability.

We shall examine what circumstances lead to a demand for bills on foreign countries, and how it is possible to check or intensify that demand.

Thus, at the close of our investigation, we shall light on many of the most important questions which have lately been ventilated in monetary circles—as to the effect of a high rate of interest in checking the efflux of gold, as to the power which foreign capitalists, holders of bills of exchange on England, may exert over our money-market, as to the result of these bills being all forced upon the money-market for discount at once, instead of being gradually encashed as they mature, and other matters of this nature—questions which are by no means theoretical or abstract, but of vital and practical importance to every one engaged in mercantile pursuits.

CHAPTER II

ANALYSIS OF INTERNATIONAL INDEBTEDNESS CONSIDERED AS THE BASIS OF THE FOREIGN EXCHANGES

THE first element which we have to consider in discussing the Foreign Exchanges is to be found, as has been already stated, in international indebtedness; the exchanges in question are exchanges of claims or debts, and an inquiry into the origin and nature of these debts will throw considerable light upon the subject.

HOW INDEBTEDNESS ARISES

It is an error often committed to imagine these debts to be incurred simply by the importation of foreign commodities, and to look on the balance of trade as a mere question of import and export as being the excess of the one over the other. It is necessary to look closer into the transactions between two countries before an idea can be formed of the position of their mutual indebtedness.

It will be discovered to result not so much from the exchange of their respective produce as from the relative totals of all the amounts expended by each upon the other, whether in payment of produce and manufactures, or for the

purchase of shares and public securities, or for the settlement of profits, commissions, or tribute of any kind, or for the discharge of the expenses incurred in foreign residence or travel : in fact, from the entire payments (or promises to pay) which pass between the respective countries. The idea of actual borrowing must be lost sight of; it is the liability incurred with which we are now concerned; and this liability is identical in its effects, whatever its origin may be.

Payments which have to be made by one country to another for any purpose whatsoever, have the same effect as payments for direct importations. Thus it is possible that the general indebtedness of two countries to each other may be almost balanced, though the one imports far more commodities from the other than those which it supplies in return. For instance, the excess may amount to three millions sterling; but the nation which, through this class of transactions, has thus become a creditor for the excess of three millions, may dispose of one million thereof in making remittances to such of its body as have taken up their residence in the other country, or have been travelling and spending money abroad: and another million may be sent to the country which has imported the excess, in order to buy up public securities; and supposing this latter country to be a great

shipping nation, another million may be due to it for freights. Thus the equilibrium between the two countries would be restored, and there would be no adverse balance on either side; the indebtedness would be equal.

EFFECT OF FOREIGN LOANS

It may not be superfluous to examine some of these international transactions more in detail. As an instance, we may examine the force of foreign loans. Treating the subject, as is at present the case, with a view to the Foreign Exchanges, a foreign loan will tell against the balance, not of the borrowing country which receives the loan, but of the lending country which supplies it.

The loan may certainly have ultimately to be repaid; but, at the time when it is contracted, it acts with the same force as an export upon the country which borrows, and with that of an import to the country which lends. In fact, the borrowing country exports its securities, which are imported by the lending capitalists, and thus, with regard to the balance of trade, to contract a foreign loan is equivalent to an increase of exportation. Sometimes when the indebtedness of a country to others becomes so great that the liability cannot be liquidated either by shipments of bullion or by an increase of exportation,

recourse is had to a loan in order to readjust the balance; the country exports public securities made for the purpose, when it has no other available resources left with which to satisfy its foreign creditors. Russia has more than once adopted this course.

Or, again, there may be a nation, rich in capital and very self-dependent, importing little, because it contains within its own limits most of its requirements, but exporting very largely. The tendency of such a country would be to become the creditor of all her neighbours. How will the balance be restored? This case is the converse of the one just now considered; the indebtedness under the present hypothesis is not excessive, but under the mark; such a country often restores the equilibrium by becoming the speculative purchaser and importer of loans and stocks and securities of all kinds; her manufactures are repaid by railway debentures, and the sums which other countries expend on the commodities with which she supplies them, she in her turn expends on the Stock Exchanges of foreign capitals.

There is no doubt but what the balance of trade is immensely affected at such times, when any great speculative mania for foreign securities springs up. In the same way as the *monetary* position of a country may be endangered when

it imports more foreign produce than the amount of its exportation, so may it be endangered by the undue purchase of foreign stocks, with the sole distinction that the latter are often far more adapted for re-exportation than manufactured goods or produce, on which the charges of shipment or re-shipment are infinitely heavier.

PERMANENT DEBTS

It will appear from the foregoing observations that, when the relative indebtedness or the balance of trade between two countries is spoken of, the permanent debts of one country to another do not enter into consideration—at least, not until the term of payment has arrived; the balance of trade depends upon the transactions which have to be settled, not upon those which by common consent are held in abeyance for a long term of years. For instance, there is no doubt that the United States owe an enormous amount to England in the shape of American securities in the hands of English holders; but with the exception of the interest on these securities, this consolidated indebtedness, as it does not require settlement, exercises hardly any influence on that floating indebtedness, by the balance of which the fluctuations in the exchanges between the two countries are determined.

These securities are articles of commerce, imported by England from America, which, at the time of their importation no doubt acted upon the exchanges equally with the cotton which came from the same quarter; and which, when they come to be re-exported to America (but not till then), will affect the exchanges in the contrary direction; that is to say, with the same force as is exercised by cotton when it is re-exported to America in the shape of Manchester goods. Otherwise, involving no immediate claim, they cannot be regarded as a set-off to the debts which we incur to the Americans for cotton and corn, and which must be settled at once. The balance of trade may be entirely against England, though the amount of American securities in English hands should immensely exceed that balance.

IMPORTANCE OF INTEREST

The case of the coupons attached to such stock is very different. The interest which they represent is a constant and important feature in national indebtedness. It constitutes an *immediate* liability incurred by the borrowing country; it is expenditure in favour of a foreign creditor. A country which has annually large sums of interest to pay abroad, must import so much less or export so much more. Conversely, a rich country with an annual income of interest from

other nations, is able, as far as this income goes, to pay for an equivalent excess of its imports over its exports. It sets off these receipts against its excessive expenditure. It may look upon them as capital coming in against capital going out.

The large sums which England receives every year in payment of interest from foreign countries, considerably reduce the balance which, notwithstanding our enormous exportation, is almost always against us; the foreign loans negotiated in England increase her indebtedness at a time when they are contracted; but the annual revenue subsequently derived from them contributes towards its reduction.

EFFECT OF PROFITS

The effect of profits and commissions on the mutual liability of nations is much the same as that which we have just described as exercised by interest. Among such profits, we may class the freights earned by the ships of various countries; the country which becomes the carrier for others thereby establishes claims against them with which it can pay for its importations from them. The charge of freight acts with the same force as a charge for a commodity actually produced and exported. An exclusively maritime country could discharge its obligations to other countries which supply it with necessaries

simply by becoming their carrier without exporting any produce or manufacture to them in return.

Or, again, a peculiar favourable position may enable one nation to make others its debtors for various tributes and commissions, and thus to obtain a revenue equivalent to one consisting of interest, of freights, or of the proceeds of exported commodities.

A country which, like England, mediates the transactions of many others, and through its position as a great banking and mercantile centre, is able to secure some slight commission or profit upon all the operations which it assists in conducting, derives no inconsiderable revenue from this source. Formerly, when London was the great emporium of goods for foreign markets, and English merchants supplied the greater part of the Continent (which was itself in no direct trade with India or America) with cotton, coffee, sugar, tea—in fact, with all the produce of the East and West Indies—the commissions and profits on this intervention must have been very considerable, and have been an important element in the income secured to the nation from foreign sources. However, the tendency of the age, which is constantly bringing the producer and consumer into closer and more direct connection by eliminating middle men and intermediate profits, is likewise exhibited in the fact that the

Transatlantic or Indian producer is brought more and more into immediate connection with the continental consumer. At present the continental shipowners and merchants make their importations from most producing countries direct, thus emancipating themselves from the London market, though not entirely from London banking facilities. The interest and commissions which are still paid by almost every country to English capitalists, certainly form a noticeable element in the revenue by which England is enabled to discharge her enormous foreign liabilities.

EFFECT OF TRAVELLING EXPENSES

An allusion was cursorily made to the expenditure in travelling or residence abroad. Russia supplies the best illustration to the force of this expenditure. Several millions sterling are annually spent by the rich Russian nobility in travelling or in foreign residence, and the capital thus taken from Russia tells against the balance of her trade precisely in the same manner as if it had been spent in Russia in the importation of foreign goods. The bills drawn by the travelling princes on their St. Petersburg bankers affects the exchanges precisely with the same force as bills drawn on St. Petersburg for the champagne sent thither from France. The liabilities incurred by foreign travel are peculiarly felt by

Russia—in the first instance, because they are of themselves excessive, in the second, because, independently of this expenditure, Russia tends to consume more than she produces.

OTHER TRANSACTIONS

There are many other international transactions which, in a complete summary of the items from which the so-called balance of trade is formed, might well deserve enumeration: for instance, import duties, or transit dues, and the whole range of Government imposts. But the consideration of the force of these charges belongs to a different field of inquiry to that on which we are now employed. The expenses of armaments to distant regions, especially the regular expenditure of ships of war at foreign stations, also form an item in international indebtedness which should not be overlooked.

SUMMARY

The preceding analysis of some of the more important elements may suffice to convey a general and intelligible notion of the different points to which attention should be directed, when a judgment as to the relative transactions between two nations, and the balance which they may ultimately present, is to be formed.

The first and principal element no doubt is to be found in the comparative imports and exports

in the literal sense of the term; but the operation of these transactions is so self-evident and generally understood, that is has not been necessary to dilate much upon this portion of the subject. In addition to the consideration of the exports and imports, it has been shown to be requisite to measure the further expenditure of nations upon each other—including therein all national extravagance exhibited in the granting of foreign subsidies or loans and in keeping up costly armaments abroad, as well as all individual extravagance, as displayed in excessive foreign travel or residence, or in speculations on foreign Stock Exchanges.

On the other hand, it will be necessary to measure the force of national acquisitiveness in securing tributes, voluntary or involuntary, from other countries: and of individual enterprise in securing to itself, by superiority of position, capital, or activity, the larger share of the advantages of international commerce. To form a correct notion of the relative indebtedness of two given countries is, from the complexity of the facts, a most difficult task; but it is hoped that the principles on which the balance should be struck, and the class of facts which should be especially searched for and examined, have become sufficiently plain to the general reader in the course of the foregoing observations.

CHAPTER III

EXAMINATION OF THE VARIOUS CLASSES OF FOREIGN BILLS IN WHICH INTERNATIONAL INDEBTEDNESS IS ULTIMATELY EMBODIED

HAVING thus passed in review the different kinds of liabilities which nations incur towards each other, we are now in a position to consider the mode of adjustment of such debts and claims, and the instruments by which it is accomplished. Most international transactions are settled by a transfer of debts, through the medium of foreign bills of exchange, and for the general reader (who has no opportunity of handling and examining the bills themselves, and of gaining, through their study, a knowledge of the various classes into which they may be divided, and the properties which attach to them), some remarks on this portion of the subject may not be superfluous.

From the point of view of the Foreign Exchanges, it must be considered that the debts contracted between different nations are on the point of being closed. Practically, credit is given, in the vast majority of cases, previously to the drawing of the bills, or the transmission of the remittances which are to settle pending accounts. With this, however, we are at present not directly concerned, though a discussion on the Foreign Exchanges would not be complete without an allusion to the fact. The knowledge that there is

a certain balance owing, for which credit is given, but which will ultimately be called in, acts, to a certain extent, upon the exchanges, just as in questions of supply and demand the knowledge that the supply may be indefinitely increased acts almost with the same force as actual present supply. But what we have now to deal with is the liquidation of debts which are becoming due; in fact, the liabilities for which the time of settlement has arrived.

UTILITY OF BILLS OF EXCHANGE

The debts between different countries, when they approach this time of settlement, are embodied, as far as possible, in bills of exchange; this mode of adjustment being universally applied, so far as the indebtedness of one country to others is covered by the liabilities of those countries to itself. It is certain that as far as accounts can be paid off without the risk and expense of bullion remittances, through simple transfers, through a direct settlement between the creditors of any foreign country and those who are in its debt, their respective debtors and creditors being left to make a corresponding adjustment abroad, so far the use of bills of exchange will invariably extend.

But how are foreign liabilities to be discharged when the claims on one side or the other are

exhausted—where there is a balance of debts to be paid without any equivalent of claims which might be set against them?

It will subsequently be found that, by somewhat artificial arrangements, it is possible that even a portion of such a balance may be settled, at least for the time, by bills of exchange. But the consideration of this more complicated question must be deferred for the present. We have, in the first instance, to deal with such foreign bills as embody actual debts and claims, and represent an exchange—an exchange made between the drawer or seller of the bill and the purchaser of the bill; the former ceding his claim on a foreign debtor against payment on the spot, and the purchaser remitting the bill to another foreigner to whom he is himself indebted.

The majority of foreign bills of exchange carry (to an eye practised in deciphering their history) the evidence of their origin and nature written upon them; and much may be learnt, both as to international transactions generally, and as to the peculiar features of the times, from a careful study of large miscellaneous parcels of bills.

THE TRANSACTIONS REPRESENTED BY BILLS

There will be found among them bills representing each of the different causes of indebtedness

which have been described. The greater portion will represent exports of produce; and this will especially be found to be the case between countries which lie at great distances from each other, and whose transactions are comparatively simple; but the closer the countries, and the more they are connected in what may be called neighbourly relations, the more diversified and complicated are the transactions represented by bills of exchange. Between the Continent and England there is a very large proportion of bills which represent the expenditure of the foreign residents, drafts on their bankers at home, and encashments of dividends or other sources of revenue.

There will be found innumerable bills based on the sales or purchases of stock, and large amounts which represent the transfer of capital from one country to another by way of giving effect to a public loan or a joint-stock undertaking. Few foreign loans are negotiated which are not accompanied by a certain issue of bills of exchange. Whenever the country which has secured a loan owes a balance on its general mercantile transactions, and is in want of remittances to cover it, bills may most conveniently be drawn upon the lending country for the amount of the loan thus contracted; for they will at once be eagerly purchased, in order to be remitted to

the foreign creditors. In the contrary case, where this is no balance requiring settlement, a loan would generally be taken in specie.

Amongst any parcel of bills there will probably be some which are drawn against freights which have become payable—a large item in those countries which have a great shipping interest, but little natural produce. Sweden or Norway, for instance, when they have remittances to make, have considerable difficulty in finding any other bills than such as are drawn either against wood (their chief article of export) or against the freights earned by their ships. They are hampered in their importations by the difficulty of making remittances in what are called "acknowledged first-class bills."

BILLS FROM THE EAST INDIES AND CHINA

There is, indeed, generally some peculiarity about the remittances from each different country: from the East Indies and China, where the chief articles of export are of great value, and where, from the necessity of large capital for bringing such valuable produce to market, the transactions are more than elsewhere concentrated in wealthy houses, the bills are to a great extent drawn in large amounts and on first-class European firms: it is very usual to see bills of ten thousand pounds, and the character of the

bills is generally exceedingly good. The distance between the two countries, and the length of credit which the purchaser of the bill must accordingly give, make great caution necessary, and render it highly important that those on whom the bills are drawn should be persons of known repute.

EUROPEAN BILLS

From the Continent, on the other hand, the remittances received are generally of a very different character: from the frequency of transactions and the facility of communication, the bills are drawn in the greatest variety of form and in much smaller amounts. They represent daily retail operations, as well as the great transactions of merchants and bankers. Any one receiving remittances from the interior of the Continent to the amount of ten or twenty thousand pounds at a time, will find the sum made up of a very considerable number of little bills. There will be bills against cattle, against eggs, against butter, drafts of travelling Englishmen on their London bankers, bills against German toys, French nicknacks, wine, fruits and vegetables. And as the transactions are now much carried on in a retail form, amongst bills on regular merchants and importers, large and small, will be found many on persons whom it is

difficult to classify, and who belong to the lower strata of the mercantile community; on agents who have persuaded German manufacturers to trust them with the disposal of their goods, and on branches of small foreign establishments who wish to try the London markets; also on shopkeepers and milliners, and others quite beyond the commercial circle—in fact, on every class whose business brings them in anyway into connexion with foreign goods.

AMERICAN BILLS

The American bills are like the East Indian bills in some respects. Being generally based upon cotton, of which a small quantity costs a large sum, they are drawn in large amounts, and represent considerable mercantile transactions. But the trade between the United States and Liverpool being much more rapidly and easily managed than between England and India, and peculiar facilities for the conducting of the operations without capital on the part of either the exporter or importer being obtainable in the cotton trade, amongst many first-class American bills there is also to be found a considerable number drawn on firms not known beyond their immediate circle, and who have no means of paying their acceptances except by the identical produce which is consigned them against such drafts.

OTHER CLASSES OF BILLS

Thus far the bills which have been taken into consideration have been assumed to represent and close direct and *bona-fide* transactions; but a large class of foreign bills perform very different functions, which it is important properly to appreciate. There is little mystery in the operations of the Foregn Exchanges when confined to the direct and immediate transactions of which we have been treating hitherto. The subject is complicated by the fact that a very large proportion of bills represent indirect operations which it is less easy to follow, and that others do not represent any actual previous transaction whatever, at least in the sense of closing indebtedness, but act in a perfectly different manner.

In the first instance, we should enumerate those foreign bills which do not represent the usual indebtedness which is assumed to exist between the acceptor and drawer, but a debt due to the drawer by a third party residing in a third country, of which the acceptor merely mediates the payment. For instance, teas shipped from China to New York are generally paid for by a draft of the exporter on a London merchant for account of the American importer. The exporter in China is paid by the price which is given him for his bill on London; and the

acceptor looks for payment to the importer in New York.

INDIRECT LIABILITIES

It is important to remember that this class of bills does not offer the same kind of evidence as others, as to the indebtedness of the country on which they are drawn; for the accepting country is a creditor of a third country for exactly the same amount as that which it must pay to the drawing country; and any estimate which might be attempted as to the liabilities of a country, based on the bills afloat upon it, which should omit the consideration of these acceptances for third accounts, would not fail to be erroneous. It is necessary at least to attempt to discover what proportion of the liabilities may have been incurred as by principals and what as by agents or middle-men. For instance, let us suppose it to be desired, at any particular moment, to consider the relative indebtedness between England and the United States. It might be discovered that the sum total of the exports of the Americans to us, in the largest sense of the word, taking into consideration all the supplementary causes of indebtedness to which allusion has been made, exceeded all that they had taken from us, or spent on us, and that accordingly we should have to remit the balance

in gold. But an element of importance would be omitted if the question were not asked, How do the United States stand as regards their imports from the East? Are there not large sums running upon England for American account, which they have still to remit? The answer to this question might lead to a different inference as to the balance.

It is especially necessary not to overlook these indirect liabilities in the case of the bills upon England, as they form a very large item in the total of our acceptances.

WHY LONDON IS THE CHIEF BANKING CENTRE

Those to whom these questions are new, may not be able at first sight to discover the cause which still compels most other countries to make London their banking centre: why it is that in the East Indies those who ship produce to America draw on London and not on New York; and why the New Orleans cotton exporter draws on London instead of on St. Petersburg for the cotton shipped to Russia.

A partial cause might be found in the credit granted by London bankers, and also in the greater reputation of the London houses, which extending to all quarters of the globe, gives a bill on them quite a different value to that which could

be assigned to bills on American and Russian bankers equally wealthy, but less widely known.

But this can only be called a secondary reason, and appears on closer examination to be itself the result of the primary cause which makes England the great banking centre of the world. That primary cause is to be found in the stupendous and never-ceasing exports of England, which have for effect that every country in the world, being in constant receipt of English manufactures, is under the necessity of making remittances to pay for them, in bullion, in produce, or in bills. It may divert its produce to other countries, but the bills drawn against such produce will be sure to find their way to England.

In other words, there will be a demand for bills on London bankers, and English bills will be more saleable than any others.

There can be no exchange on any place to which remittances have not constantly and regularly to be made. And *vice versa*, when remittances have to be regularly made, an exchange is soon established, and the intervention of a mutual centre is not required.

For instance, England exports fabulous quantities of Manchester goods to the East, and silver into the bargain, receiving in exchange tea and silk. But suppose the tea and silk which England requires to be less in value than the merchandise

exported. How can the balance be regulated? As follows: The Americans export very little to China, but require more tea and silk from the Chinese than what they give them in goods. Consequently, the Chinese have a surplus claim on New York. This they transfer to their English creditors, to whom they are indebted for the surplus value of the goods imported from England over their own produce shipped to England; in other words, they remit to their English creditors the bills drawn for American account, or instruct the Americans to send gold to England for the amount. The instance given is but an illustration; if the particular case is not entirely correct, many others might be supplied in its place.

That the imports of England exceed her exports does not invalidate the present proposition; it is the universal diffusion of the products of English industry which tends to bring about the results described. England buys from, and sells to, almost every country in the world. Of other countries, A may import from B, but export to C; and if B and C are not in constant intercourse, A will not be able to pay B by giving him an assignment on C. However, A, B, and C are all commercially connected with England, and thus A can pay B by assigning to him a claim against England, which he himself

has received in payment from C; or more simply, C draws a bill on England and remits it to A in payment, and A passes it on to B, who being in constant connection with England, is in his turn easily able to use it.

DIRECT SETTLEMENTS

As illustrations of the converse proposition, that, where there is a regular and constant interchange of imports and exports between two countries, an exchange is at once established by which transactions may be settled without the intervention of England, may be cited the cases of Java and Holland, of New York and Bremen, of Rio Janeiro and Hamburg. Formerly, when Germany was farther behind England in her exports than she is at present, the New York houses paid themselves for their shipments of tobacco or other produce to Bremen, by drawing for Bremen account on England, and Bremen would settle the transaction by buying up and remitting to England the bills of the Holstein cattle-dealers or of the butter-exporters of the Low Countries. But now so many German manufactures are sent to the States, that there are always buyers for bills drawn on Bremen direct; or, more simply, the tobacco and cotton shipped to Germany is paid for by German manufactures, and no further intervention is

required. What becomes then of the cattle and butter bills, which are thus set free? These are still collected in Bremen and remitted to England, but against different transactions.

The regular mutual intercourse established between New York and Germany does not yet exist between Germany and Bombay. Bombay as yet takes very little from Germany, the great bulk of her dealings being still with England; consequently, the Bombay merchants, finding few purchasers for bills on Bremen, still draw on London for German account, when they ship cotton direct to the Continent: and a transaction takes place which in fact amounts to this, that they direct their London creditors to obtain payment from their German debtors. Accordingly these latter are still under the necessity of buying up bills on England, as constituting the most convenient remittance by which they can effect these payments to English merchants which their Bombay creditors instructed them to make.

A very large proportion of the foreign bills afloat will, on a careful analysis, be discovered to represent adjustments of this kind; that is to say, not direct but indirect and intermediate settlements, in which London appears as the clearing-house of the world, where most international transactions are closed.

BILLS DRAWN IN BLANK

It remains to consider those foreign bills which represent no settlements of indebtedness at all—bills which are technically said to be drawn in blank, by which the acceptor does not pay his debt to the drawer, but by which, on the contrary, the drawer incurs a debt to the acceptor. The part which these bills play in all questions of the Foreign Exchanges is very considerable, and requires careful attention. A portion of them approach nearly indeed to the character of what in the home trade are called accommodation bills; they may be drawn by merchants in one country on merchants or bankers in another, in order to secure the use of the money which is paid as their price, for the time during which the bills have to run. The purchaser of the bills in this case takes the place of the discounter of accommodation paper, and the transactions may be perpetually renewed in the same way and with more facility than accommodation bills.

But there is another function of bills drawn in blank and representing no actual transactions, which is little understood by the general public, but which, nevertheless, is in many cases very important and expedient.

It is very possible, and indeed probable, that the imports and exports of any country will not

fall into the same period of the year; and that, consequently, the seasons when the imports have to be paid for will not coincide with the seasons when payment is exacted from foreign countries for the exports.

In the case of a purely corn-growing country, for instance, the revenue derived from foreign countries will come in at the conclusion of the harvest, when the cargoes of corn begin to be dispatched. There will then be bills drawn against these shipments on the countries to which they are directed. Meanwhile, however, the country in question has been importing manufactures from its neighbours all the year round, and the importers have been requiring bills on foreign countries in order to make remittances, long before the corn-bills could be drawn and become available. If no other device could be found, the importers would, before the harvest-time, be obliged to remit gold abroad in payment of their purchases; and afterwards the exporters, not being able to sell their bills, which the importers would now no longer want, would have to receive back the equivalent of their exports in remittances of gold from abroad. Thus the risk, the expense, and the reduction of circulation, which are consequent on repeated journeys of bullion, would be twice incurred, owing to the exports and imports

of the same country falling into different seasons.

This difficulty is often avoided if the bankers in one country draw upon those in another, at the time when no actual commercial bills, representing *bona-fide* transactions can be bought, and subsequently square the liability which they have incurred towards the acceptors of their bills drawn in blank, by buying-up and remitting the export-bills as soon as the goods have been shipped and are made available for drafts. Thus the importers are able to procure bills from such banking houses at a time when otherwise they could buy no bills at all, and the exporters sell to the same bankers later on at a time when otherwise they would find no purchasers, the importations having been previously paid for.

The same object is often sought for and attained by the exporting houses receiving permission from those to whom they sell or consign their shipments, to draw bills in anticipation of the goods being actually dispatched. Thus they are enabled to sell the bills at a time when there is a demand and when a premium is likely to be paid by the importing branch of the community, instead of waiting for the time when the bulk of the exports are dispatched, and when consequently, from the number of those who have to

draw bills, they would have to accept a lower price.

Great complaints have been made in the Court of Bankruptcy, and in many quarters where the force of such transactions is not clearly understood, of what is called the system of blank credits; in other words, the system of drawing bills from abroad not representing at the time any actual settlement of indebtedness. The reason may probably be that it is easy to confound such bills with accommodation paper. And it is true that wherever the existence of these blank credits has been brought before the public, it has been owing to some catastrophe in which the bill transactions actually were only undertaken with the intention of raising fictitious capital.

But it will have been seen that blank credits may serve a legitimate and useful purpose, only requiring to be most jealously, and even suspiciously watched.

Those who are not versed in the various details of international banking transactions will have some difficulty in understanding how foreign bills, representing mutual accommodation, and merely intended to raise a fictitious capital during the time which the bills have to run, may be distinguished from bills drawn to anticipate actual transactions, and to bridge over the

interval which exists between a season of importation and a season of exportation. Yet to a certain extent it is possible to do so, in the same way as the discounting establishments at home are able to distinguish between legitimate and fictitious inland drafts. The system cannot be condemned because it is often abused—at all events, not until it becomes evident that the abuses which follow in its wake are greater than the advantages which its secures.

For the present, however, it is not necessary to inquire into the beneficial or pernicious results of these bills drawn in blank. They have simply to be enumerated as constantly forming a portion of the aggregate amount of foreign bills afloat, and as playing a peculiarly important part in affecting the Foreign Exchanges. The fluctuations in the prices of foreign bills, which constitute the real subject-matter of every treatise on the Foreign Exchanges, can only then be properly understood, when a tolerably accurate insight has been gained into the nature and character of the bills themselves, and the various classes under which they may be ranged.

The foregoing chapters have accordingly been devoted, in the first place, to an elementary inquiry into the transactions in which foreign bills have their origin; then to a more minute analysis of that international indebtedness

which we discover these bills to represent; and finally, to the classification and characteristics of these bills when actually drawn. We have, so to speak, examined the material and the machinery, and are now in a position to study the operations themselves.

CHAPTER IV

ENUMERATION OF THE VARIOUS ELEMENTS OF VALUE WHICH DETERMINE THE FLUCTUATIONS IN THE PRICES OF FOREIGN BILLS

When the Foreign Exchanges are in actual operation, and adjustments of accounts are taking place between different countries, it appears at once that, though the purchase and sale of foreign bills originally represent a simple transfer of debts, and thus, at first sight, seem to exclude the idea of varying prices, the value of these bills is, nevertheless, in a state of constant fluctuation. The enumeration of the various elements of value which determine these differences in price forms the next step in our inquiry, and is rendered possible by the fact that, while every instance of such variations admits of a special practical explanation, all are, nevertheless, subject to well-defined general laws, and capable of scientific analysis.

The primary difference of value clearly arises, as was previously pointed out, either from the aggregate amount of the claims of any given country upon others exceeding the sum of its liabilities to them or, *vice versa*, falling short of that sum.

PREMIUM AND DISCOUNT

In the first case, those who have bills to draw (whom for the sake of conciseness we will call the exporters, though the class embraces all those who have claims of any kind on foreign countries) will not find sufficient purchasers to take all their bills; for only those will buy who have debts abroad to settle, and these debts are by our hypothesis of less amount than the claims. Accordingly the exporters, competing with each other for the sale of the bills, will take less money for them than their nominal par value; that is to say, will sell them at a discount.

In the second case, the importing class, those who have incurred liabilities to foreigners, having, by our hypothesis, larger remittances to make than the exporters can supply to them, bid against each other for such bills as may be got, and pay a premium to secure them.

In both cases, what exporters and importers are seeking to avoid is the transmission of bullion, with all the sacrifices thereby entailed, and accordingly the extent of the premium or discount which can be given is determined by the extent of these sacrifices.

Let us suppose that importers foresee that the bills which they will be able to procure, will not suffice for all the payments which they have to make. They at once become aware that the

balance will have to be remitted in bullion; and each individual, to avoid this necessity falling to his share, hastens to offer a slight premium to those who draw, intending by this small sacrifice to secure himself against the greater loss in freight, insurance, and interest, which is always involved in a bullion remittance. The premium may rise to within a fraction of this expense or loss; nay, may even reach that actual point; because though the premium paid for the bill and the cost of the specie remittance were absolutely equal, it would still be more convenient to send the bill.

Beyond this point the balance of trade cannot cause the premium to rise; nor, on the other hand, can it cause the discount at which bills are sold ever to exceed the sacrifices which exporters would incur, if they found themselves obliged to instruct their foreign debtors to send them bullion, in consequence of bills upon them no longer being saleable.

TIME AN IMPORTANT CONSIDERATION

The time, however, when they would receive payment would, in this case, be an important consideration. As long as the exporters can find purchasers for their bills, they get payment at once; but when they cannot dispose of their bills any more, they are not reimbursed for the

value of their exports till the equivalent for them is returned in gold. Accordingly each individual will submit to a sacrifice in order to sell his bills before the demand for them is exhausted and a discount is established; but the discount will not be greater than the estimate which the seller makes of the sacrifices which have been pointed out.

AN ILLUSTRATION

The result becomes perfectly clear when stated in actual figures, especially if an illustration can be found where the par value of bills drawn between two commercial centres is not hidden or rendered more complicated by differences of currency.

New Orleans and New York, before the secession, when their respective currencies had not been disturbed and divided by independent issues of inconvertible paper money, supplied an instance in point. Under the hypothesis of an identical currency, if at any time the amount of bills on New York offered for sale in New Orleans equalled the amount of remittances required for the payment of debts due to New York—that is to say, if the indebtedness of the two cities reached the point of equilibrium—the price to be paid for a bill for one hundred dollars payable at sight in New York (for differences in point of

time, and consequently of interest, should at this stage be eliminated) would be exactly one hundred dollars. In proportion, however, as it might become evident, that a greater sum was due to New York than could be drawn against the claims of New Orleans upon that city, those who were bound to remit would hasten to pay a small premium to the drawers, and give them one hundred dollars and a half, under the apprehension that if they did not secure these bills, they might be obliged to send gold, which might cost them one and a half dollar for each hundred dollars in freight and insurance.

Thus the more clearly it appeared that the stock of bills was growing insufficient, and the more the supply actually diminished—the higher the premium was sure to rise, till the sellers might realize almost one and a half dollar profit. At this point the premium was clearly so high, that it would be indifferent to remitters whether they bought bills or sent gold, and some would dispatch gold and others buy the bills, the surplus excess required to be remitted being in the meantime gradually lessened by this dispatch of gold. The exporters, being less pressed for their bills, soon had the opportunity of feeling the change in the situation, and might content themselves with a smaller premium in order to secure some profit before the demand was entirely

satisfied. The result would be a fall in the price of bills, till the exchange stood once more at par, or below it.

Conversely, if at any time there were more bills than purchasers for them, the drawers, feeling that their export business might have to bear the charge of one and a half per cent for bullion shipped to them from New York as returns, were ready to sell at a discount long before that point was reached; a discount which would, however, not exceed the charges on bullion shipments, which, in the case in point, we have supposed to be one and a half per cent.

LIMITS WITHIN WHICH EXCHANGES VARY

It is a clear deduction from these considerations, that the limits within which the exchanges may vary (provided the bills are drawn at sight and in the same currency) are, at the one extreme, the par value, plus the cost of the transmission of bullion; at the other extreme, the par value, minus this identical sum.

Practically the exchanges rarely touch either extreme, but fluctuate between them, owing to the various measures and influences brought to bear upon the situation before the extreme case arrives, which cause a reaction in the opposite direction.

There are occasions, however, when the exchanges sink and rise much beyond the specie point; and as this is not to be accounted for by the cause which we have been engaged in analysing, viz., a balance of indebtedness either in favour of, or against any given country, we must endeavour to discover others.

Such an instance occurred in the first months of 1861, when, under the growing apprehensions of civil war in the United States, fluctuations occurred in the American rates of exchange which extended far below the specie point.

The balance of trade had been strongly in favour of America. Very considerable exports of grain and flour, coupled with a reduction of imports, in consequence of political apprehensions, had established a surplus of claims on foreign countries over the debts due to them. Accordingly it was natural that the exchanges should fall to specie point; but the fact was, they fell much below it. How could this be accounted for?

The reason must be sought in the peculiarly urgent necessity under which the exporters were labouring, of selling their bills immediately at any sacrifice. It was a question of time. Three or four per cent were sacrificed to secure the proceeds of the bills on England at once, instead of waiting for the arrival of gold. The exporter

had two courses before him—either to sell his bills at what they would fetch, or to send them himself to Europe, with instructions to his correspondents to encash them and remit the amount in bullion. The latter course was cheaper, but as he required funds immediately (or, under the influence of panic, believed that he would so require them), he adopted the former.

In ordinary times, capitalists would have competed with each other in buying up the drafts of urgent sellers. They would then have remitted them to Europe for their own account, so as to secure the profit between the low price paid for the bills and their specie value; that is to say, they would have bought at a heavy discount, much below specie point, in order subsequently to realize at least the specie value (which we have seen to be the par value, minus the charges on the bullion remittance).

But at a time of commercial panic, such capitalists are seldom willing to launch out into a speculation which deprives them, during the weeks which must elapse before the gold arrives, of the command over their funds. They may fancy that during that interval the rate of interest may rise to such a height as to neutralize the anticipated profit. For instance, let us suppose that they expected to gain one and a half per cent net on the exchange: in their calculation

they must have taken into account the interest they would lose from the time when they paid the drawer for his bill up to the moment when the returns in gold arrive. The amount of interest on this interval, which we will call a month, they may have calculated at six per cent per annum, or one half per cent for the month. Now, if the rate of interest should suddenly rise to twenty-four per cent per annum, they would have to borrow money at the rate of two per cent for the month, in order to replace that portion of their capital which is travelling to Europe and back; that is to say, one and a half per cent more than they had calculated on; and accordingly, that being their estimated profit, they would gain nothing on their exchange operation.

We accordingly may conclude that what is technically called a stringent money-market, acts materially upon the exchanges, inducing sellers to force sales, and creating a reluctance on the part of purchasers to buy unless absolutely compelled to remit. This cause will, however, not come forcibly into operation, when the international transactions are in a state of equilibrium; for then there will be as many purchasers on compulsion as there are sellers, and the dearness of money may only operate so far as to induce purchasers to defer their remittances to the last moment, whereas sellers would wish

that they should be hastened. Its full force will be felt at a time when the country where money is supposed to be dear, or where panic exists, has exported more than it has imported, and when it is consequently certain that gold will finally have to be ordered, while no individual is himself willing to wait for its arrival. It is seldom, however, that this peculiar contingency will occur; as, generally, the money-market in such a country as has taken less from other countries than it has given to them is particularly well supplied with surplus capital.

FURTHER CAUSES OF EXCHANGE FLUCTUATIONS

There are, however, further causes which determine the fluctuations in the rates of exchange.

We have hitherto, in order to obtain a clear view of the first leading principles, considered all bills as drawn payable at sight; but, practically, an immense majority are drawn payable at various periods after the date of their issue or first presentation to the acceptors, giving rise respectively to the expressions, payable at so many days after date, or so many days after sight. Thus, two new elements of value are introduced which will affect the rate of exchange. In the first place, the consideration as to what deduction should be made from the price, in

consequence of the bill which is bought for ready money not being itself payable till after a certain time; and, secondly, as to the security which the purchaser of the bill can feel that the drawer and acceptor of the bill will continue solvent till it becomes due. Thus, the state of credit in both countries, and the rate of interest in that country whither the bill is remitted, likewise become determining elements in the rate of exchange.

It has been shown that the stringent state of the money-market in the country where the bill is drawn affects the exchanges since it renders the seller more eager and the purchaser more reluctant; and, as one or the other must bear the loss of interest which must ensue till the proceeds of the bills reach their hands, this loss of interest will be at the rate established in their own money-market at home.

But when any bills other than such as are payable at once, form the subject of bargain, the buyer must further consider what is the rate of interest in the country on which the bills are drawn. If he owes money abroad, he will be paying interest to his foreign creditor at the foreign rate, and this interest will not cease till his remittance becomes due. Accordingly, it will make a difference to him of two months' interest at the foreign rate, whether the bill which he

purchases as a remittance is drawn payable at once or sixty days after its arrival; and, as the foreign interest rises, he will insist on paying less for the sixty-day bill, whereas, if it falls, he can afford to pay more. A heavier deduction must be made from the price in the first instance than in the second.

Or, in the case of the capitalists who buy up bills at a time of pressure in order to send them abroad and have them converted into gold, their foreign correspondents will have to discount the long bills for them, and the amount of discount affects their profits. If they fear the rate of interest in the country on which the bills are drawn will be high, they pay so much less for the bills; if they anticipate cheap rates, they pay so much the more. Without any doubt, the New York capitalists, who suffered the price of bills upon England to sink three and four per cent below the specie point, were influenced by a natural anxiety as to the rate which they would have to pay in England for the discount of their sixty-day remittances.

In the rates of exchange for all bills other than bills at sight, there is no element of value so constant and so effective as the rate of interest in the country on which the bill is drawn. The fluctuations in bills at sight are limited, to a certain extent, by what we have called the specie point:

they can exceed the specie limit either upwards or downwards for a time; but, be it remarked, only when the two countries are at a considerable distance from each other, so that specie cannot be rapidly sent to and fro, and when immediate returns become a matter of importance; in fact, only under very extraordinary circumstances.

The fluctuations in long bills, on the other hand, are unlimited, because they are co-extensive with the fluctuations in the value of money in the accepting country, and co-extensive, too, with the apprehensions which may be felt as to the solvency of the names on the bills. The effect of the value of money, or rather of every variation in the prevailing rates of discount, upon the Foreign Exchanges, is a matter of the highest importance, and will have to be considered with some minuteness later on.

IMPORTANCE OF CREDIT

On the other hand, the extent to which the solvency and credit of the drawer, as well as of the acceptor of a bill, affects the value of that bill, and consequently the rate of exchange at which it will sell, does not require much elucidation. Firms of first-rate standing are said, in technical language, to "make the best exchanges." The price which is paid to a merchant of undoubted position for his sixty-days' sight

bill on a foreign country, will be higher than that which is granted for a second-rate bill on the same place. The purchasers of bills must be induced, by a concession in price, to take an article of inferior security. They must be indemnified for the greater risk.

Credit is a very important element to be considered in the rate of exchange; and so notorious is this amongst those engaged in international trade that the price at which exporting houses can sell their foreign bills is looked upon as an unerring test of the credit which they enjoy among their neighbours. Thus credit causes a difference in the value even of such foreign bills as are drawn on the same day, rendering it difficult to give any exact or definite quotation of the price of long-dated paper; and, further, it operates on exchanges generally in times of commercial panic or excitement, and causes the prices of all bills to fall.

In the case of America, to which allusion has been made, doubtless the purchasers of bills felt bound to indemnify themselves by a large discount for the risk which they thought they ran; either the bills might not be accepted at all, in consequence of an enormous fall in the value of the goods against which they were drawn, and the drawers whom the purchaser would then have to call upon to refund the amount, might

have failed in the interim; or, the bills might have been accepted, but not paid at maturity, owing to the difficulties in which it was expected that all connected with America would be involved.

Thus, too, when a whole nation falls into discredit, it is difficult to sell bills upon it, and large concessions must be made in consequence. It is felt that little security can be placed in the acceptor. The purchaser has then only the security of the drawer, and not, as is otherwise the case, of the drawer and acceptor jointly. However, this argument cannot be pushed very far; for, generally speaking, when a whole country is in discredit, there are many other influences at work to lower the value of bills upon it, and it is not easy to separate to what extent the different causes have respectively operated; how much, for instance, is due to a so-called adverse balance of trade and excessive indebtedness, how much to loss of credit, and how much to a further element of value which we have still to examine—the depreciation of the currency.

DEPRECIATION OF THE CURRENCY

It will be remembered that the basis of a settlement through a bill of exchange is the payment of a sum of money in one place in order to

receive the equivalent at another. The purchase of a bill on France consists in the payment of a certain amount in sterling money to a merchant trading with France, against his giving an assignment for the same value on a French merchant.

Hitherto, all that has been said has been applicable to all countries equally. The principles which have been examined would exist, and be in constant operation, even if a universal currency had been adopted, and the perplexing calculations between francs and florins, and dollars and roubles, were no longer necessary.

But now we have to deal with the actual facts that when an exchange of a given sum in London for the same sum in Vienna or St. Petersburg has to be made, it is excessively difficult to ascertain what may be called the par value. When there is a gold currency in both countries, the calculation is comparatively easy; though if a large paper currency exists side by side with the gold, the problem becomes somewhat more involved. Between two countries of which the one has a gold, and the other a silver currency, a comparison becomes still more complicated, while it is hopeless to look for any trustworthy results when either of the two countries has an unlimited or inconvertible paper currency.

Given one hundred pounds sterling in London; what is the value of these hundred pounds in Vienna? What are the laws which will govern the exchanges in this case? Applying experimentally the principles which we have previously examined, we discover them apparently to break down here. The fluctuations in the prices of foreign bills have been exhibited hitherto as confined within certain limits, subject indeed within these limits to the ordinary laws of supply and demand, but unable to rise or fall beyond the indicated boundary, except under extraordinary circumstances. If the drawers were more numerous than such as had to remit—that is to say, if the creditors of any given country were more numerous than the debtors—it was shown to be difficult to sell bills on such a country, and the sellers had to make a sacrifice. On the opposite hypothesis, the buyers were mulcted in a premium. But in either case, the sacrifice could not materially extend beyond the loss which would accrue directly and indirectly in the transmission of bullion.

If he who has money to claim abroad, cannot draw and sell a bill against the amount to advantage, rather than submit to a sacrifice beyond the limit indicated, he will instruct his foreign debtor to send him gold. So if he who owes money to merchants abroad cannot buy a bill

except at a loss greater than the expense of sending bullion in payment, he will naturally at once adopt the latter plan.

But what is to be done in either case, if the country on which we suppose the bills to be drawn, has an unlimited paper currency, represented by no bullion at all? or, if bullion cannot be thence obtained except at an enormous premium? or, if the export of bullion is prohibited altogether, or, if it be illegal to give or take a premium of gold?

It seems evident at once that the limits previously assigned to the fluctuations of exchanges are, under most of these hypotheses, removed altogether. If the creditor of such a country loses the alternative of being able to obtain gold in payment of his claim, there is no limit to the sacrifice which he may be compelled to make, in order to sell his bill, except in the competition of those who may be obliged to purchase it. Similarly, if, as is very unlikely in the case of a country with a depreciated currency, its foreign debtors should be more numerous than its foreign creditors, so that the demand for bills upon it would exceed the supply, the debtors (being deprived of the alternative of sending a specie remittance by the fact that gold, though enhanced in value like everything else by the depreciation of the currency, still is prohibited

from commanding in the country in question its legitimate premium) would have to pay the price demanded by the sellers of bills, this price being apparently only limited by the competition of sellers.

However, on closer inspection, it will be found that a kind of limit, similar in nature to that which has been pointed out, is after all in operation; and it will be possible to discern it when the case of a country in which there is a depreciated currency, but in which a premium on gold is regularly established and is not restricted by artificial means, has been examined. It will appear that, in this latter case, we shall not be far wrong if we add the premium commanded by gold in the depreciated currency to the expenses which are incurred by the creditors of such a country, who have to recover their claim by sending for the gold instead of selling bills, or if, in the opposite case of the debtors, we make a corresponding deduction. If the latter, rather than pay an extravagant price for the bills which they wish to purchase and remit, incur the expense of sending bullion, the premium which they will obtain on such bullion will naturally go in reduction of the expenses incurred. This will accordingly give them a great advantage over the sellers; in other words, over the creditors of the country in question.

The consideration of the various cases under examination, from the two opposite points of view of the drawers and purchasers of bills respectively, tends to embarrass the course of the argument, but cannot be avoided entirely. When in the course of the discussion the case of one class only is considered, it is highly desirable that the reader should himself clearly realize the converse proposition, and consider the results from the opposite point of view.

In propounding, the fact, that the fluctuations in the prices of bills on a country where the currency is depreciated are governed, not only by all those elements of value previously considered, but to a much greater degree by the premium on bullion as compared with the depreciated currency, we are stating the final result rather than the process by which this position is reached—the ultimate limit, rather than the gradual development. We shall arrive at the same conclusion by the following reasoning, in which more prominence is given to the depreciation of the paper circulation than to the premium on bullion, which, however, in reality is almost the same thing. Practically, the idea of the premium on bullion, though more easily and clearly intelligible in theory, rises less to the surface than the depreciation, or smaller purchasing power, of its paper competitor.

INCONVERTIBLE PAPER CURRENCY

For, in a country where there is a large inconvertible paper currency, the precious metals tend to recede from their more important function as the circulating medium, while their character of ordinary merchandise comes out into stronger relief. As another currency exists, with which they are by no means identical, they no longer constitute the standard, but themselves become subject to another standard. Accordingly, when, owing to this new standard, the prices of all merchandise begin to fluctuate, bullion is subject to the same influences; and when, through the over-issue of paper money, a general rise of prices ensues, the price of gold, as measured by paper money, rises with the rest.

Thus, supposing the Austrian Government to be constantly depreciating the Austrian currency by issues of paper money, the value of gold in Austria will be constantly rising, and one hundred English sovereigns will be worth so many more Austrian paper florins. Those who purchase a bill on Vienna will, accordingly, in such circumstances require a corresponding exchange; they who have bills on Vienna to sell, that is to say, to whom a certain sum of florins is due in Austria, will have to throw in so many more florins, in order to induce the buyers to give them gold for the depreciated article. And why?

Because, otherwise, the buyer who is going to remit would do better to send the gold itself. Just as an English traveller in Austria will at such a time obtain fifteen florins instead of ten for his sovereign, so will those who pay sovereigns for florins on the London Exchange, require the same favourable terms.

We have thus discovered an influence which apparently affects the fluctuations in the Foreign Exchanges far more powerfully than any previously discussed. Interest of money, a balance of debt over claims, panic, distance, and so forth, practically cause the exchanges to vary within a few per cents. A variation of ten per cent owing to all these circumstances combined, is considered something extraordinary, and only occurs under rare combinations. But as soon as the element of currency is introduced, we have had at once an instance before us in the Vienna exchange of a variation of fifty per cent. So in the Russian exchanges, owing to the enormous amount of paper money afloat, which is practically inconvertible, the most violent fluctuations are constantly occurring.*

* This passage was written in 1861. Great changes have since then occurred in the Austrian and Russian Exchanges. The former has fallen very considerably, and the florin is worth much more than it was two years ago. The Russian rouble has even touched its par value. But the measures taken to bring the Russian currency to its specie value have broken down, and the paper rouble is still, what it was when the above passage was written, practically inconvertible.—December, 1863.

But in a certain sense these fluctuations are apparent, and do not involve the same gain or loss, the same difference in value, as those alluded to above. As the depreciation in currency affects, generally speaking, all prices alike, the fifteen florins bought by the Englishman for his sovereign are not worth more to him than the ten which he bought for the same money before. When the fluctuations were determined simply by the balance of trade (within the limits of the specie point upon either extreme), the purchaser when he bought cheap—that is to say, when he obtained a greater sum than usual in foreign coin for his own money—secured an actual advantage; this greater sum of foreign coin had an actual purchasing power. But where the cheapness of the bills is caused by the depreciation of the foreign currency, he has no advantage; for the purchasing power of the nominally larger sum is not greater than that of the smaller.

Again, while the purchaser of the bills has been shown to have no advantage, so neither, after the new standard of exchange is established, has the seller any loss; it is true that he will be under the necessity of ceding a greater number of florins for the sovereign which the buyer pays him; but the produce which he has sent abroad against which he draws, will, under our present hypothesis, have risen in value in the same

proportion, and therefore yield him a proportionately greater number of florins for which he can draw. For instance, before any great fluctuation, he exported a certain quantity of sugar, and sold his drafts against this sugar for a certain price: let us suppose him to have sold the sugar for 10,000 florins, and to have sold these florins at the rate of ten to the pound. He would thus realize £1,000 for his sugar. A fluctuation of ten per cent now occurs, owing to an over-issue of paper in Austria. Prices generally rise 10 per cent and the exchange rises also. The same foreign merchant now sells his sugar for 11,000 florins, but he must sell his florins at the rate of eleven to the pound, thus realizing £1,000, precisely as before.

It is scarcely necessary to observe that in assuming a general equal rise in prices, it is not intended to express an opinion that such an event could actually occur. Some prices will rise much more than others, according to the well-known principles of political economy relative to this subject. In Austria the manufacturers insisted that they made considerable profits by the depreciation of the currency, as the cost of labour had not risen in the same proportion as the manufactured goods. The raw material being imported from abroad had risen to the full extent at once; and this enabled the manufacturers

to increase the price paid for their products in the same ratio, though one element of production, labour, remained comparatively stationary. But this could only be temporary. The adjustment must take place sooner or later; and if the demand for labour had remained the same as before, wages would have risen till they commanded the same amount of the labourer's necessaries as before.

As far as the force of the previous argument is concerned, the assumption of a general equal rise of prices is admissible, and it will appear that the apparent fluctuation in the exchanges extends no further than the apparent increase of value which has resulted from the same cause. A parcel of manufactured goods commands more florins, and an English sovereign commands more florins also; but neither in the one case nor in the other has any greater purchasing power been acquired.

Hitherto the comparison has been instituted between a transaction before any given fluctuation and a transaction after it; and it appears that the difference in the exchange, when it has been caused by the depreciation of the currency, does not give rise to any difference of result. However, it will be seen at once that the very opposite is the fact, when the fluctuation is not supposed to occur between two different

transactions, but between the beginning and the end of the same operation.

Suppose the exporter of sugar to have shipped his sugar first, and to have sold it, as assumed before, for 10,000 florins, the exchange being at the time 10 florins to the pound. However, he defers his drafts against these 10,000 florins for some time, and, in the interval, the rate of exchange changes to 11 florins to the pound, as in the previous case Accordingly, his florins, having to be divided by 11, realize only nine hundred and nine pounds odd, instead of the thousand, which the former exchange would have given him. In fact, a fluctuation in the exchange, produced by a depreciation of the currency, makes the existing claims on a country in such a situation worth so much less, whereas all debts due to it can be so much more advantageously discharged; the creditor of the country loses and its debtor gains. If its imports and exports were in a state of equilibrium, that is to say, if it owed as much as it had to claim, there would, on the aggregate of transactions, be neither loss nor gain resulting from the apparent fluctuation; but the individual creditor of the country might consider himself robbed, and the individual debtor might rejoice when proceeding to discharge his liabilities, to find himself able, for the same sovereign, which previously

would buy only ten florins, now to purchase eleven.

LIMITS OF FLUCTUATION

The examination of the nature and tendency of the fluctuations just described, serves to lead us conclusively enough to their limits, which is the special object of our present investigation.

The bills on a given country fluctuate in value in proportion to the extent to which the prices of all purchasable articles—bullion included—are affected by the depreciation of the currency; in other words, in proportion to the discount of the paper money, or the premium on gold. Beyond that proportion, the fact of the depreciation of the currency cannot cause them to deviate; otherwise, if it were possible, the creditor of any sum payable in the inferior money, rather than submit to a further sacrifice in the exchange, would request his debtor to send him gold for the amount of his debt, notwithstanding the premium upon it; for, under the hypothesis, such a premium would be less than the loss entailed in settling the transaction by the sale of a bill.

DIFFICULTIES IN OBTAINING PAYMENT

What, however, will be the case if the export of bullion from the country, where the depreciated

currency exists, is prohibited? or if it is impossible to buy up gold, either because it is illegal to pay a premium, or because all bullion has actually disappeared?—And these are the more frequent cases which, in practice, arise. How is the holder of a claim on such a country to encash that which is due to him?

Let us suppose the case of a merchant who had supplied Russia with cotton when the export of bullion from Russia was practically prohibited. How was he to exact payment? When the cotton was sold, he became entitled to a certain amount of roubles in St. Petersburg. How could he convert those roubles into English sovereigns?

Or, put the case otherwise: a Russian spinner has imported the cotton, and owes the amount thereof in English sovereigns to a merchant in Liverpool. He has roubles sufficient in his hands in paper money, but what steps is he to take to procure sovereigns for them? Being debarred from sending bullion, he has only two courses open—either to buy a bill on England from others who happen to have sent produce thither, and thus have a claim on an English house, which he can buy and transfer to his Liverpool creditor; or to send the produce, which will sell for sovereigns, himself. Where there is a pause in exportation, as is the case

during a large portion of the winter season in Russia, he would be absolutely unable to send any remittances at all, unless he could find bankers or others who might draw on England, or on some other foreign banking centre, in anticipation of future exports, and would sell him the bills. But it will be apparent that as to price he is entirely in their hands.

If, as is often the case, such Russians as are indebted to foreigners are bound at any cost to place funds in English money into the hands of their creditors by a given day, there would be no limit to the price which might be exacted from them—in other words, no limit to the fluctuations in the exchange. The relative value of their paper roubles to bullion seems not to enter into the question at all. Supply and demand alone determine the price. And if the exports of such a country do not equal the imports (and this is by far the most general case) so that the demand for bills to pay for the imports exceeds the quantity of bills which is supplied by the exports, the balance which the country has to pay can only be settled by an enormous sacrifice—in fact, cannot be settled at all except by a cessation or diminution of imports, or by a foreign loan, the latter being only an expedient to gain time and an adjournment of the payment of the balance due.

It will easily be seen why it is possible to assume that a country in which a depreciated currency and a prohibition to export bullion exists, is likely to be importing more than it is exporting. If it were otherwise—if its exports exceeded its imports—bullion would be flowing towards it; other countries would be paying part of their debts to it in gold, and no grounds for a prohibition of the export of bullion would have existed. The currency, too, would be in the course of improvement, and not of depreciation.

EXCESSIVE IMPORTATIONS

Probably there are as many cases in which the depreciation of the currency is, directly or indirectly, the consequence of excessive importations, as in which it is due solely to the errors and bankruptcy of Governments. Often, both influences are combined, taking alternately the position of cause and effect. Sometimes Governments, simply for their own purposes, issue a quantity of paper money: the natural consequence will be over-importation; prices will rise in consequence of the increase in circulation, and accordingly attract commodities from other markets, while the exports, having risen also, will be less easy of sale abroad. Or, over-importation takes place in the first instance, and

Governments, in order to remedy artificially and apparently what can only actually be remedied by the cessation of the real primary cause, commit the fatal error of increasing the circulation by an issue of paper money. They think thus to increase the means of paying the debts which are being incurred; but the only effect is, still further to increase the evil; for importation, instead of being checked, is fostered by such a plan.

When, during a period of apprehension caused by a large efflux of gold from England to America, views were expressed in Manchester and Liverpool that a much larger issue of bank-notes ought to be permitted, this opinion tended manifestly to a depreciation of our currency. But as the consequence of the depreciation of the currency in any country is to offer inducement for further importation, by creating an appearance of high prices, and at the same time to increase the difficulty of paying for such importations, how is the final balance to be paid? The efflux of specie shows that the balance of trade is against that country for the time; the equilibrium must be restored, when the specie is exhausted, by slackening importations and consumption.

We were led to these somewhat premature reflections regarding the results of an over-issue

of paper money and over-importation, by the consideration of the position of such debtors to foreign countries as were prohibited, either by the actual absence of bullion or by legal enactments, from making specie remittances, and were, therefore, entirely at the mercy of such as had drafts on other countries to sell—their only resources being, in case they were met by prices too exorbitant, to buy produce and send it themselves. The fluctuations in the exchanges in these cases will depend entirely on supply and demand; and, if the demand for bills exceeds the supply, there is theoretically no limit whatever to the price of bills.

It may, however, be asked what will be the general range of the exchanges in such a case, if the importations and exportations are, for a time, in a state of equilibrium? What would be the natural value in sterling money at such a time, of a bill on St. Petersburg, payable in roubles? The natural value at such a time seems to be, not the nominal par of exchange, not the value of the rouble when it was convertible and was in reality a silver coin, but this value minus the depreciation which the rouble has suffered in Russia itself. If at the time when the currency in Russia, owing to the enormous amount of paper money afloat and the insufficient stock of bullion to meet it, was actually—though perhaps

unconsciously to the Russians themselves—depreciated 5 per cent, then we apprehend the natural value of the rouble in sterling money would have been at such a time 5 per cent below the nominal par of exchange; but it cannot be too often repeated that no calculation can be founded upon this proposition, as practically, owing to the system of credit and deferred payments, there is never an equality between exportations and importations; and an increasing balance of debts lowers more and more, at least in reference to the Foreign Exchanges, the value of what, in this case, we have called the rouble.

THE CASE AS BETWEEN SILVER AND GOLD

Such seem to be the general principles which regulate the fluctuations of the exchanges in those cases where bills are sold payable in a depreciated currency.

The treatment of the subject would not be complete without considering the case as between silver and gold. When a bill on Hamburg, payable in silver, is bought in London for a certain price, payable in sovereigns, what will determine the value?

We shall arrive at this value by a similar process of reasoning as determined the previous case. Either gold or silver will be at what may

be called the par value between the two, or, as is more generally the fact, the one will be at a premium as compared with the other. With the exception of France, which with its double standard is subject to somewhat different influences, gold is simply merchandise in such countries as have a silver currency, and silver is merchandise in such countries as have a gold standard; and according to the price of the merchandise at a given moment, so will the exchanges fluctuate.

When a bill on Hamburg is to be sold in London, all the previous elements of value will have to be taken into consideration—the rate of interest in the two countries, the state of credit, relative indebtedness, and so forth; but the value of silver in England will enter largely into consideration, or in the opposite case, the value of gold in Hamburg.

When there is a great demand for silver in England, as is the case when large shipments are to be made to the East, there will be a great demand for bills upon Hamburg; for one means of procuring silver will be to buy up such bills as entitle the purchaser to a certain amount of silver in Hamburg, and to send these bills for encashment, with instructions that the silver thus encashed is to be actually shipped to England.

Thus, if silver is at a premium in England, those who have claims on Hamburg are able to exact this premium from the purchaser of their claims by raising the price of their bills; that is to say, the buyer will have to pay more sterling money for the same amount of "marks banco," or, what comes to the same thing, he will receive less marks for his pound sterling. If when silver is not at a premium, he receives thirteen marks and a quarter for his sovereign, as the price of silver rises he will receive less; for instance, only thirteen marks and an eighth; and the exchange on Hamburg being expressed by the number of marks banco which are to be had for a pound, the exchange on Hamburg will be said to have fallen; the fact, however, being clearly that bills on Hamburg have risen in price, a less amount of marks commanding the same amount of gold.

Conversely, supposing the case of a Hamburg merchant who wishes to procure gold for any purpose whatever—let us say for the purpose of sending it to America to buy cotton therewith—bills on London will serve his purpose, as they entitle him to an amount of that metal which he requires; and if there is competition for such bills, owing to a general demand for gold for the object indicated, those who have bills upon London will be able to exact a premium for them,

and in this case more marks banco will be demanded for every pound which is placed in London at the disposal of the purchaser of the bills; accordingly, the Hamburg exchange will rise, and thirteen marks and a half may be given for the pound.

The limit of the fluctuation is, however, easily discernible, and will be found to correspond exactly with that which was discovered in the case of two countries, one of which had a metallic currency and the other a depreciated currency, with a premium permissible on gold. The limit will be the extent of premium obtainable.

If the holders of bills on London, in the case last put, exact too many marks, those who are anxious to purchase gold will find their advantage in sending the silver itself over to England, and selling it there for gold; or if the English merchants, who desire to ship silver to the East, find that the price demanded by such as have bills on Hamburg to sell, is out of proportion to the existing premium on silver, they will either pay that premium for such silver as may be procurable elsewhere, or they will send gold to Hamburg, sell it there at the discount at which gold will stand in Hamburg, under the circumstances, and have the proceeds invested in silver and shipped over to them.

The assumption necessary for the argument

is that a sale of gold is always possible in Hamburg, and a sale of silver possible in England; the price may, in either case, sometimes be exceedingly low, and the premium on the other metal accordingly be a heavy charge to the purchaser; but the sale may generally be assumed to be possible, and thus defines the limits of the fluctuations in the rates of exchange.

This result has, in the case before us, been attained by the consideration of transactions which arose from the fact of certain merchants being obliged to possess themselves of that one of the two precious metals which did not constitute the currency of their own country, and endeavouring to obtain it by the purchase of bills on such countries where it formed the standard.

The truth of the proposition is, however, quite as self-evident if we confine ourselves, as before, to the case of debtors and creditors.

OTHER ILLUSTRATIONS OF THE LIMIT OF FLUCTUATIONS

An English merchant owes a certain amount of Hamburg money; that is to say, an amount which he is bound to pay in silver. Silver, let us suppose, is, when his debt becomes due, considerably dearer than usual in England. The amount of the difference he will be compelled to

pay either by purchasing silver in the English market at the enhanced price and shipping it to Hamburg, or by buying a bill on Hamburg, payable in marks, at an unfavourable exchange. The price of silver having risen, the price of bills payable in silver rises also, and the purchaser will receive fewer marks for his pound; but if the seller of the bill were to ask a greater difference of price than would be warranted by the rise of silver, those who have payments in silver to make will prefer to pay the premium in the open market for the article itself. Thus the limit of the fluctuations in the rates of exchange which may result from the difference in value between gold and silver is clearly and easily established.

The case of transactions between two countries like England and France, of which one has a gold currency, and the other a currency of gold and silver combined, offers no difficulty whatever. The fluctuations in the prices of bills of one upon the other cannot, except under a most rare and almost impossible combination of circumstances, exceed the limits of such variations as can exist between two countries having the same currency: they will be determined by that which is common to both of them; that is to say, by gold. How, indeed, could a bill on Paris, payable on demand, be sold at a higher value

than that of the gold which it represents, plus the expenses and commissions incurred in sending that gold to Paris? For, if a higher price were asked, it would be cheaper to send gold itself.

It is clear that, as soon as a premium is paid in any country on gold or silver, this premium will increase the value of bills which are payable in that particular metal—but only if they are payable in no other. If a bill on Paris is payable either in napoleons or in silver five-franc pieces, it will be sure to be paid in that coin which is least in demand, in that which is at a discount as compared with the other. Thus, the purchaser of such a bill will not allow the price to be enhanced by the existence of a premium on one portion of the currency. The fluctuations in the rates of exchange will be as strictly limited as they were shown to be when the currencies of any two countries were practically identical.

In concluding this portion of the subject, it is necessary to remark once more that no stress should be laid on any of the special cases selected as illustrations being correct in fact. It is rather the mode in which the question should be handled and the principles, which the present treatise endeavours to evolve, on which reliance should be placed when any particular instance is to be analysed and examined. For this purpose the

different elements of value which enter into consideration in the sale of foreign bills, have been dwelt upon at some length; but the proportion in which they stand to each other in any particular case, and the details which must be studied in considering how far the currency of one country coincides with or varies from the currency of another, do not fall within the scope of this inquiry.

CHAPTER V

REMARKS ON THE INTERPRETATION OF THE FOREIGN EXCHANGES

In the preceding chapters we have been occupied in tracing the origin and development of the transactions which result in the Foreign Exchanges from their simplest to their more complicated forms, with the special object of discovering the various causes which combine to produce constant and important fluctuations in the prices of foreign bills.

Having gained a theoretical insight into the principles of the system, we are now in a position to approach the more practical and interesting portion of the subject, and to examine it in its direct bearing upon commerce in general. Being acquainted with the influences which are proved to determine the fluctuations in question, we are enabled, by a reverse process, to argue back from them to the existence of their determining causes, and to consider the Foreign Exchanges in their peculiarly valuable character as an unerring mercantile and monetary barometer. But they are more than this. Not only do they offer to the trading community the means of ascertaining the state of the commercial

atmosphere—indicating when the air is charged with a storm, or when fair weather is likely to set in—they so clearly point to the disturbing currents that their study and due comprehension suggest the course by which danger can be avoided, and moderate the precipitate action of panic.

"FAVOURABLE" AND "UNFAVOURABLE" EXCHANGES

The general feeling with regard to the function of the exchanges, as giving evidence of the mercantile (or rather monetary) situation of any country, is indicated by the usual phrase of a "favourable" or "unfavourable state of the exchanges," a phrase which occurs so frequently in all banking discussions that it cannot be passed over without remark. Of its inaccuracy, in so far as it enters into the domain of political economy and applies to the general prosperity of the country, it is not necessary to speak. It may originally have implied the erroneous theory that the object of commerce is to attract gold, and that that country towards which the tide of bullion sets with the greatest force is *ipso facto* the most prosperous; that, accordingly, a position of the exchanges which points to an influx of specie is favourable, whereas, when bills become so scarce that the precious metals must be

exported, the situation is eminently unfavourable. But the phrase is accurate enough from the monetary or banking point of view. Under the present state of legislation all engagements involve payments in gold or in paper convertible into gold, the merchants engaging to pay in gold or bank-notes, at their option, and the Bank of England being bound by law, without option, to pay those bank-notes in gold.

Consequently, it is of the highest importance to the whole banking and mercantile community, with a view to the certain fulfilment of such engagements, that the aggregate stock of bullion in the country should suffice to meet all wants. Whether the law is wise in itself is beside the argument, so long as the currency laws continue as they are. Under present circumstances a merchant or banker will consider that to be an unfavourable state of things which points to a *dangerous* diminution of the stock of gold, and he will consider that a favourable turn of the exchanges which tends in the opposite direction. When the stock of gold is evidently adequate, it is even in a banking point of view erroneous to consider a further accumulation advantageous or desirable. And just fault may be found with the use of the term "favourable exchange" beyond the limits of the sufficiency of the bullion

for the purposes of the currency; for the temporary excess of gold at one point is of no advantage whatever, but rather the reverse. The limit of the phrase should be strictly kept in view as legitimately applied to express the anxiety or confidence of the banking world as to the means of meeting their legal obligations. And accordingly there is no real discrepancy as to the class of facts which, in practice, the words "favourable and unfavourable" exchanges denote.

Political economists, from their point of view, are correct in their statement that, as regards the country at large and the interchange of commodities, exports and imports are always balanced, and that both the words "unfavourable balance of trade" and "unfavourable exchanges" involve a fallacy.

But merchants and bankers are influenced by the feeling that at any given moment they may be under greater liabilities for imports than they can temporarily meet, owing to the system of credit which disturbs the coincidence of payments for exports and imports, though their value may actually be equal; and further, by the anxiety as to the possibility of meeting these liabilities in that specific mode of payment to which they are pledged, namely, in gold or convertible notes.

THE MEANING OF THE TERMS "FAVOURABLE" AND "UNFAVOURABLE"

A proper understanding on these points is absolutely necessary, as otherwise differences of opinion might be supposed to exist, while the difference does not lie in the opinion or the theory, but simply in the application of a technical phrase. When, therefore, in banking treatises, it is said that the exchanges are favourable to any particular country, it should be understood that the intention is simply to state the fact that bills of that country upon foreign cities are difficult of sale, whilst bills drawn upon it from abroad are at a premium, indicating an eventual influx of specie. So, when it is said that the exchanges are unfavourable, a situation is described in which foreign bills are in great demand, and when, consequently, their value seems likely to be so enhanced as to render the export of bullion an unavoidable alternative.

It is necessary to call attention to another point before we proceed to consider the interpretation of fluctuating rates of exchange.

SHORT BILLS

It must be borne in mind that it is the price of short bills, not of those which have some time to run, which determines the course of bullion shipments. Most of the primary elements of

value affect long and short bills equally; but the rate of interest and the question of credit exercise an additional influence upon the former, and so modify the fluctuations in their price as to render them unreliable as indications of the currents of gold.

If there is a demand for bills upon any particular town, the price of all such bills, whether short or long, will rise. That is the general tendency. If, however, in the city in question, the rate of interest were at a very high point, it is evident that the price of long bills would not rise in the same proportion as that of short; for the purchaser must bear the discount, which has to be deducted from the long bill before it can become equally available with the short bill; and for any increase in this discount he requires to be compensated by a so much cheaper price. He must be compensated in the same manner for the risk which he will run till the bill be ultimately paid.

As an index of the general position of trade, the value of short bills is the more important; whereas the rates given for long paper, as compared with those for bills on demand, point mainly to the rate of interest, and partially to the state of credit.

Bearing in mind the existence of this distinction in those cases where (as, for instance,

between London and Paris) the short exchange is the most prominent, and not straining it too much where owing to various circumstances, long bills only are to be obtained to any amount, as is the case in St. Petersburg, we may now proceed to illustrate the method to be followed when it becomes desirable to interpret the indications afforded at any given moment by the Foreign Exchanges.

THE MANY CAUSES OF FLUCTUATIONS

It results, from the whole tenor of the previous arguments, that it is, above all, essential to remember that fluctuations can arise not only from one cause but *many*, and that till proof is given that actually no other influence is at work than the one which may be selected as possible and plausible, no trustworthy opinion can be formed. It is an error often committed, when scientific subjects are superficially or popularly treated, to consider it enough to point out one cause as sufficiently accounting for any phenomena, regardless of the fact that it is far more important to prove that there are no other causes which could have led to the same results. But on no occasion does this fallacy more frequently blind the judgment than in questions of mercantile finance, possibly because the facts with which they have to deal are so complex and entangled

that any clear and intelligible solution of the difficulty is held to be sufficiently satisfactory, without regard to the necessity of applying further tests.

Half of the benefits which might be derived by a study of the exchanges is lost in consequence of the tendency to be satisfied with the first plausible explanation. Egregious errors might be committed if an argument were founded on the state of the exchanges between Hamburg and London which relied on the balance of trade alone, without considering the difference of value which would result from a premium on silver, the currencies of the two countries being dissimilar. So it is not sufficient to consider the Russian exchanges simply as indicating the enormous indebtedness to foreign creditors, to the exclusion of the influence of the depreciated currency.

A notable instance of the necessity of never losing sight of any of the various elements of value which enter into the prices paid for bills of exchange, and also a valuable illustration of the question of interpretation generally, was afforded by the extraordinary course of the American exchanges at the beginning of 1861. A large efflux from Europe to the United States took place, and various theories were started as to its cause. But strangely enough, months elapsed before it was clearly acknowledged and

understood by the majority of the public that this efflux of bullion was mainly the consequence of indebtedness. Another explanation, grounded on the growing troubles in the States (which were leading to a kind of panic) and on the presumed speculations of English capitalists, had been put forward as sufficiently explaining the prevailing drain; whereas the test of indebtedness should have been applied first of all. The specie shipments were hurried and intensified by peculiar modifications of that indebtedness; for instance, by the Americans drawing sooner than usual against their claims on England, by their suspending their orders for English manufactures, and by the forced and unnatural increase of exportation even of articles not wanted in Europe.

But the primary cause of the fall of the exchanges which led to the flow of bullion to America lay in the immense excess of their exports of wheat and flour, following, too, on a cotton crop of unprecedented extent. Independently of the political crises, Europe would have had to pay a balance to America in gold; and this was surely the cardinal point to keep in view, in considering whether the export of bullion would continue or cease. Such authorities as, at the commencement of the efflux of bullion, insisted on considering it as a simple speculation,

and pointed to the folly of the merchants who sent it out, prophesying that probably it would return to them in the same ships, committed the error of looking principally to the stock of gold in New York, to the speculations in American securities, and to the operations of capitalists, rather than to the one broad fact, which was clearly discernible on closer inspection, that England and Europe were simply paying for their importations from America.

Stress was continually laid upon the fact that the stock of gold was accumulating in New York and was decreasing here, and it was argued that consequently the gold must return. It is plain, however, that for this result to take place, one of the following events would have to occur; either the bullion would be returned because the Americans owed money to us, and sent it to pay their debts; or it would be remitted against fresh orders for English manufactures or for American stocks held in English hands; or it would be sent here as a loan to English capitalists, in the expectation that money would, as was certainly probable, become dearer here than in America. Those who maintained that bullion would return, were bound to prove that one of these operations would take place. The first was a question of fact: Did the Americans owe much to Europe? The second was a question of

probability: Was it likely that the Americans would regain sufficient confidence to enter upon new mercantile transactions? The third was also a question on which opinions might be divided: Was it probable, or the reverse, that in a time of great national emergency the New York bankers would remit their capital for employment to Europe, because gold accumulated rapidly in their vaults?

These were the questions upon the solution of which the slow or rapid return of bullion depended, and they might fairly have been made the subject of discussion. But to argue that, because in 1857 the bullion which was exported to America was immediately returned, the same result would be witnessed in 1861, was to overlook the fundamental and primary element of value in the Foreign Exchanges—the relative indebtedness. In 1857 the Americans had incurred enormous debts to Europe; in 1861 Europe had incurred enormous debts to them. Here was the key to the whole position. On the former occasion the export of specie to the States was unnatural and artificial. It was lending your debtor more, in the place of exacting payment. On the latter occasion the export of bullion was natural and inevitable, because it was made to discharge a debt; but the payment was somewhat hurried, and the usual rules were

a little set aside, because the creditor (the American), finding himself in the midst of a most dangerous political crisis, became suddenly urgent to receive all that was due to him, and to forestall, rather than to delay, the settlement of his claim. He drew his bills and forced them on the market with the eagerness of panic. Few buyers were to be found requiring them as remittances in discharge of European liabilities; for trade had been curtailed, no new orders had been given, and, before the crisis commenced, the unusual prosperity of the Western States, in consequence of vast crops of grain, had made it possible for remittances against previous transactions to be sent earlier than usual.

Thus, the bills were brought up in New York, not by such as had liabilities to discharge, but by such as were willing to advance the value of the bills till their equivalent in gold could be procured from England. This was the office of the New York banks, and by far the greater quantity of the bullion shipments consisted in what may be called the anticipated proceeds of these bills. Without the influence of panic, a high rate of interest on this side might have delayed the export of the proceeds, at least till the maturity of the bills. If these proceeds had remained longer on this side, they would either

have constituted a loan to the banker to whom they were remitted, or they would have been invested in some kind of merchandize, and returned in that form rather than in gold. What other alternative was possible?

It may be asked, Why, if the balance of trade, in its simplest sense, was, to use the popular phrase, in favour of America—that is to say, if they owed less than they had to claim—why then, was there any ground for panic in New York?

The answer is clearly that, from a monetary point of view, not only was there no reason whatever to induce a panic, but, on the contrary, there were evident grounds for confidence. Sellers of bills might foresee a difficulty in disposing of them above the specie point, and consequently up to that point press their bills upon the market; but the only apprehension that could be felt was, as to whether they would be able to obtain facilities till the time when the equivalent of their bills, if remitted to Europe to be converted into specie, would return into their possession.

The aggregate of a community cannot be alarmed at the position of its money-market and of the exchanges, when the whole world is indebted to itself, at least so long as it has every confidence in the solvency of its debtors. The

panic, if it may be called so, which occurred in America during that winter, was attributable *solely* to political causes, which rendered all who had bills for sale eager to underbid each other for the sake of immediate payments, and to accept a price far below what they would have realized if they had had their bills exchanged into gold in England. It was this urgency to secure themselves money at any price which induced the New York merchants to export every kind of produce, which normally, owing to the increase of the currency, would have risen in value in the States, to European markets, where prices were sure to fall owing to the decreasing currency. A panic usually occurs in the money-market of any country when the exchanges become unfavourable to it; but it is a rare occurrence to see alarm felt at an unusually favourable situation of the exchanges.

The ambiguity of the term "favourable exchanges," unless it be taken within the limits given above, that is to say, as denoting a simple monetary fact, and not as any judgment on the prosperity of trade, can be easily appreciated in this instance. The exchanges, when at such a point that the necessity of specie remittances from England to America was clearly indicated, were, as the phrase is, highly favourable to America, and the very reverse to ourselves.

The American exporters of grain and cotton were, however, the very class who, in the first instance, suffered most from the situation, in so far as the expense of the costly transmission of specie, with all the losses attached to it, would fall upon them.

On the other hand, the English debtors may be argued with some plausibility not to have suffered any loss, because to them it was immaterial how they paid their bills at maturity—whether by handing the amount over to their neighbours, to whom the Americans would, in normal times, have remitted bills upon them; or by shipping it in gold by order and for account of their American creditors. But to a certain extent there is a fallacy in this, as the charge on the exporter so often falls on the consumer of the produce exported. To this extent the interests of the exporter become identical with those of the foreign country. For, that which adds to the cost of the article which he exports must be borne either by him or by the consumer of his produce; and it is their joint interest that no such addition should be made. The cost of the transmission of bullion is an addition of this nature; and, therefore, it is contrary to the interest of the exporter, and of the country to which he exports, that such an expense should have to be incurred.

EFFECT OF IMPORTATION OF SPECIE

Thus we come to the position that a condition of the exchanges which leads to the importation of specie into any country favours the importers and consumers of that country, but causes an additional charge to the export trade. However, the extra charge upon this export trade having ultimately, on the above supposition, to be paid by foreign countries, it may be maintained that the state of the exchanges indicated is, in a certain sense, favourable to the country in question, and unfavourable to the foreigners with whom it trades.

A clearer view may be gained of this position if it be assumed for the moment (what is partially true) that each country *fetches* from the other that which it requires; in other words, that the export trade of a country is managed upon the order system. Cotton and grain may be sent from the States, not for account of American sellers, but of English buyers, who have given their orders. If the article is bought by a foreign buyer in the place of its production, it is plain that any sudden extra charge upon exportation must be borne by him; and thus a sudden fall in the exchanges, which makes his bill upon his London house less valuable, or causes the whole cost of the transmission of bullion from England to pay for his purchases to fall upon

him, becomes unfavourable to the country to which he belongs, and for which he is buying, and not to that from which he is buying.

Conversely, the Americans who give orders to English manufacturers are able, during the same period of low exchanges, to buy up bills on England which will pay for their goods, at a cheaper rate than usual, and are able to save the expense of the transmission of bullion, which, during normal times, generally falls on a portion of the American importers. As far as facility and economy in paying for the products of other countries are concerned, a state of the exchanges which renders it possible to purchase bills to pay for them, cheaply and easily, may correctly be designated as favourable.

FURTHER REMARKS ON INTERPRETATION OF EXCHANGES

Returning from this digression, which was prompted by the desire of throwing additional light on the use of the words "favourable and unfavourable exchanges," and resuming the consideration of the general mode in which the Foreign Exchanges are to be read and interpreted, we shall find in the course of the American Exchanges during 1862–3 further materials for instructive analysis. In 1861 we saw an extraordinary depression in the price of foreign bills

in New York. The situation was afterwards reversed. After the lapse of a certain interval a rise of extraordinary extent and rapidity occurred. How was this change to be interpreted? To what phenomena did it point?

No better illustration for the examination of the different influences which affect Foreign Exchanges could be found. Here we have a case where the effects were evidently greater than could be caused solely by a change in that which we have called the primary element of value—international indebtedness; for the rise went far beyond the normal specie limit.

The sudden transmission of capital from America to Europe, and the continuance of a demand for importations from abroad, while the exportation of cotton was stopped by the blockade of the Southern ports, might account for the phenomenon to a certain extent, but not beyond what we have so often called the specie limit. We are driven to look for another element of value, for one more unlimited in its operation; and that will at once be found in the depreciation of the currency, of which alone, among the various elements of value determining the price of foreign bills, it could be said that it rendered fluctuations illimitable. The passing of an act suspending specie payments in the United States, and authorizing the issue of inconvertible

Government paper money, removed the normal specie limit, and the extent to which the prices of foreign bills could rise at once became an open question. It was to be anticipated that the effects of a depreciated currency would be developed to their full extent, and it became possible for the Foreign Exchanges to rise, not a few per cents, but 50 or 100 or even 200 per cent. In the Southern States the exchange on London actually rose to 400 per cent.

Experience was at fault as to the probable practical limits, and theory could only establish, as a result certain to ensue, that with every issue of inconvertible paper money a progressive rise, proportionate to the depreciation of the currency, would unavoidably take place. Strangely enough, in the Northern States the rise was actually delayed far beyond the time when it was expected to occur, and the Americans began to believe that it was possible to print paper money without losing gold, or depreciating the remainder of the currency.

The causes of this delay well deserve examination, though, from the complexity of the facts, it is difficult to arrive at any certain results. Two causes have been suggested which are sufficiently plausible: the one that, during the first months of the issue of the Government paper money, the private banks called in their

notes to a very great extent, and that thus the aggregate currency was not increased as much as might have been expected; the other, that the area over which the American currency extends is so vast that the effects of an over-issue of paper would be less rapidly felt.* It was said, too, that in the West a considerable dearth of currency had previously existed, and that, consequently, there was a gap to be filled up. However this might be, the satisfaction which was felt by the Americans at the issue of paper money without a heavy fall in its value was of short duration, and the theories of political economy were abundantly justified in the end. An unexampled rise in the American exchanges took place, the exchange advancing by degrees in little more than a year from 110 to 180.

In a former chapter, the endeavour was made to gauge, as far as possible, the probable extent of fluctuations in the exchanges arising from a depreciated currency, and it was shown that where a premium in gold was not prohibited by law, the prices of foreign bills would rise in proportion to the extent to which prices of all purchasable articles, bullion included, are raised

* In a criticism on the second edition of this work, two further causes have been suggested which no doubt were also in operation: the general contraction of credit throughout the States, and the enormous war expenditure; both of which circumstances would unquestionably lead to the absorption of a considerable amount of currency.

by such depreciation; in other words, in proportion to the discount on the paper money, or the premium on gold. Beyond that proportion, the fact of the depreciation of the currency would scarcely cause them to deviate. Accordingly, on examining the price of foreign bills in New York and the price of gold, we shall see that they constantly rose and fell together. Before the depreciation of the currency, the actual par of exchange for bills on England was, as will presently be explained, expressed in the form of 109. When gold rose, the foreign bills rose as much beyond this point of 109 as gold rose above par, leaving the same margin (and the same variations within that margin) between the premium on gold and the price of sterling bills as that which, in normal times, existed between the nominal par of exchange and the actual mean premium on English bills: but this margin, which was 9 per cent before, having itself to be calculated in depreciated currency, became apparently—but only apparently—greater.

HOW VALUE CALCULATED IN AMERICA

In order that this may be properly understood, it may be necessary to state the mode in which the value of bills on England is calculated in America. The basis of the calculation is that forty dollars are equal to £9, so that the dollar

would be equal to 4*s*. 6*d*. But as this assumed par of exchange does not coincide with the actual value of the gold in the dollar and the sovereign, the £9 being worth 9 per cent more than the forty dollars, gold for gold * (by which the value of the dollar is reduced to about 4*s*. 1½*d*.), the calculation has to be rectified, when bills on England are bought, by 9 dollars being added to every 100 dollars of the purchase-money. It was a fact that, as long as a gold currency existed on both sides of the Atlantic, the actual par of exchange between New York and London was about 9 per cent nominal premium, or as it was technically phrased, bills on London stood, when the exchanges were in a state of equilibrium, at 109. This difference (or corrective premium) of 9 per cent *in gold currency* would be modified, either upwards or downwards, by the various other influences to which the Foreign Exchanges have been shown to be subject, by the state of indebtedness, the rate of interest, in fact, by supply and demand; but it constituted the mean specie point. After the depreciation of the currency, when prices of bills as of other articles were no longer expressed in dollars having a certain value in gold, but in dollars of depreciated value,

* The exact difference between the gold contained in 9 sovereigns and in 40 dollars is nearer 9½ than 9 per cent, but the quotation given in the text is accurate enough for the general argument.

it was to be expected that the same actual difference of 9 per cent in gold would still enter into the price of foreign bills, but that it would be expressed in its equivalent of paper dollars; in other words, that these 9 per cent would also be increased in exact proportion to the premium on gold.

Thus, we arrive at the following result: If, before the issue of paper money, the purchaser of a bill on England paid 100 dollars and 9 dollars for it, he would, if the premium on gold had risen to 50 per cent in the first place pay 150 dollars instead of the 100, and in the second $13\frac{1}{2}$ dollars instead of 9 dollars, or half as much again as what we may call the correcting premium. Thus, if the price of bills, when gold stood at 150, was $163\frac{1}{2}$, this price would correspond to the price of 109 at the time when there was no premium on gold. The price might rise to 165 or fall to 161, according as there was supply or demand, but the mean point would be ascertained by the process which has been described.

Disturbing causes were introduced by legislative enactments which interfered with the free commerce in gold, and consequently tended to vary occasionally the relative value between bills and gold, by encumbering all operations in the latter with certain charges and inconveniences.

Taxes on transactions in gold would have the same force as increased charges on specie shipments, and would thus have a tendency to widen the margin between the premium on gold and the premium on bills.

And, besides the taxes imposed on operations in gold, there were other circumstances which induced those who had occasion to buy either foreign bills or gold, to give a preference to the former, so that a somewhat artificial demand arose. For instance, fears were continually entertained that the export of gold might at any time be prohibited, either directly or indirectly; and thus, naturally, the preference was given to that species of remittance of which the export could not be forbidden. Or again, if gold or bills were to be purchased in order to be hoarded or held some little time before being used as remittances, interest would be lost upon gold but earned upon bills; for when these came to be sold, they would be worth so much more, as being nearer their maturity.

Similarly, there were charges and risks, needless to specify, incident upon the holding of gold, which were not incurred in the holding of bills, and thus many considerations (but especially the constant interference of the Government) would tend to widen the margin between gold and bills, and create violent perturbations at

particular moments which could not be accounted for simply by the depreciation of the currency.

The extraordinary state of the Foreign Exchanges in America during the period with which we have been dealing, is peculiarly difficult to explain in a simple form, but is all the more instructive because it offers the opportunity of viewing the different elements of value in simultaneous and sometimes conflicting operation.

The depreciation of the currency by the issue of "greenbacks" exercised, it is true, so overwhelming an influence, as to have rendered difficult the discovery of the operation of other elements of value. These, however, so long as any foreign trade subsists, can never be entirely absent. According as the Americans have remitted their funds to this country, in order to secure a portion of their fortune against the contingency of progressive depreciation, so has there been a demand for bills upon England. Immense sums are said to have been remitted to English bankers by American correspondents, because this was clearly the safest course by which to secure their fortunes against loss and at the same time to earn a moderate interest. In America every species of banking investments was subject to daily depreciation, and such fortunes as consisted in securities payable in dollars, were rapidly melting away. Investments in gold

were largely resorted to, but as we have explained, they were dangerous, on account of the action of the Government, and unremunerative, owing to the loss of interest. Remittances to foreign countries combined the advantage of security with that of remunerative employment for capital, and many millions sterling have been sent to Europe for this purpose. Some surprise has been caused by the fact that the gold remittances from New York have not been so great as might have been expected. But a portion of the capital which thus found its way to England flowed through an indirect channel. It was sent from the ports of California instead of from the port of New York. By the adoption of this course, the great risks on the transmission of gold from California to New York were avoided, while the object of remittances to Europe was as conveniently attained.

Without these bullion remittances the demand for bills must have been even greater than it was; for the Americans required funds in England, not only for the purposes which have just been indicated, but also for the payment of the large quantities of military stores purchased in this country, and for that amount of European manufactures which, however much the Americans may curtail their trade, they are obliged to purchase for immediate wants. No cotton bills

being obtainable in New York, owing to the blockade, and fewer corn bills existing, owing to the reduction of that trade in consequence of plentiful harvests in Europe, no doubt the demand for bills (notwithstanding the Californian remittances) has been great, and this demand has increased the premium on sterling bills.

But this increase of the premium, it will be remembered, can never exceed the expense, the risks, and the inconveniences, in their widest sense, on bullion remittances. For as soon as this margin between the premium on gold and the premium on bills on England, exceeded the 9 per cent to which we have alluded, plus the premium on these 9 per cent and plus the expenses on shipping the bullion—those who desired to remit, would, as explained before, rather ship the bullion itself; and as the export of gold had not been prohibited, a remittance in gold could always be made.

With many apparent discrepancies, the upward course of the American exchanges was really governed by the few simple principles which have been discussed in the earlier portion of this treatise. Amidst the complexity of the particular combination, the effect of the few leading causes which lay at the bottom of the whole, stands out clearly enough, and, it may be repeated, the rise in the price of foreign

bills, owing to the unlimited issue of greenbacks, could be predicted with the most absolute certainty.

THE FALL IN GOLD

It is less easy to explain the rapid fall which followed on the battle of Gettysburg and the opening up of the Mississippi. But the difficulty lies rather in explaining the fall in the premium on gold than the fall in the prices of foreign bills, the latter being simply the consequence of the former. It is true, indeed, that in a question of the interpretation of the Foreign Exchanges, the premium on gold is only a collateral issue. But as we have followed the rise in gold, it may be interesting briefly to examine its fall.

If a redundancy of currency created the premium, it would seem natural that only a diminution of the over-issue should cause a corresponding fall. The conversion of some portion of greenbacks into stock was a measure operating in this direction, but it was accompanied by fresh issues, which neutralized its effect. Besides, this conversion was in operation before the fall, even at the time when the premium was rising, and therefore cannot have contributed to the sudden fall in any great degree.

The result would rather be due to the belief suddenly springing up that the quantity of paper

money would really be reduced, either by a further more effectual conversion, or by a redemption in bullion at a shorter date than appeared possible during the darker period of Northern prospects. It is scarcely possible to judge whether the fall in gold was justified or not, without venturing on an opinion as to the ability or the intention of the Washington Government to reduce that currency which it has for its own purposes created; but the belief on the part of the American community that this intention and ability did exist, no doubt exercised some portion of the influence which actual measures taken by the Government would have produced. This belief had the further effect of inducing persons, who had hoarded gold from a fear of a further depreciation of the currency (and who had even before been somewhat alarmed by the measures taken against this very hoarding by the Government) to sell their stock of gold as fast as possible, giving up the idea of a further rise. And the Government, too, is said to have contributed, by somewhat artificial means to a premature decline in the premium on gold, by throwing large sums on the market which it had been able to accumulate, as it was thought, for this very purpose. If so, a reaction is highly probable. An over-issue of paper money can only be counteracted by a subsequent contraction. It

may be possible, perhaps, by artificial means, to discount this result, but not to produce it.

And thus it is to be anticipated that, unless measures are taken to follow up temporary expedients by permanent improvements, the price of gold may once more advance.* On the other hand, the adoption of such measures is facilitated by the fact of the position of the Americans being favourable in this respect—that their currency is depreciated simply by internal and not by external causes. Probably they owe less to Europe than they have done at any other previous time in late years, and they have the further advantage that the large deposits which they have made in Europe, give them the power, at any moment they may want it, of regaining a great portion of the gold which they have lost.

EFFECT OF COTTON TRADE REVIVAL

As to the extent to which the revival of the cotton trade may affect the exchanges, and compel Europe to send bullion to America, many circumstances will have to be considered. It will be a question of time, rather than of indebtedness. The Americans will be in need of

* The correctness of this view was practically demonstrated even before the second edition was issued. An advance in gold again took place, which has since, with many fluctuations, made further progress.—December, 1863.

large quantities of goods from this side, and the question will be, whether they can supply us faster with cotton than we can supply them with goods. The probability is that we shall be more urgent for cotton than they for manufactures; but it is less certain that the quantity of cotton required will be immediately available, whereas the export of our manufactures on its former scale can, if necessary, at once be renewed. However, on the whole, as we may certainly assume that we shall immediately want the cotton, and as, from the disorganization of the cotton trade, credit will be less available, and cash payments more imperative, the probable necessity of an export of bullion on our part seems to preponderate, though not to the extent that is generally believed.

A most important consideration will be, whether the Americans will be anxious to receive gold with a view to re-establish a metallic currency, or whether, owing little to foreign countries, they will be content to let their depreciated currency continue in the state in which the end of the war may find it, fancying, perhaps, that it may right itself. What, it may be asked, will be the value of gold to them, if they neither require it for internal circulation, which they may think can be managed as well by paper, nor for the payment of foreign liabilities, from which,

under our hypothesis, they will be comparatively free?

Nevertheless, gold will be the only equivalent which, if they do not immediately take large quantities of goods from Europe, we shall be able to offer them for cotton. Consequently we may expect one of two things to happen. Either though they may not have the immediate intention of improving their currency, the premium on gold, through the abundant supply which the circumstances indicated will place at their disposal, will fall to such a degree as to hasten their action in spite of their indifference; or, what is quite as probable, the temptation will rather be to increase their imports than to improve their currency; a great inflation of prices and of trade in general will ensue; the inducement which a redundant circulation of paper money so often creates, of importing to an unlimited extent, will have its full effect; and foreign liabilities will thus be created which will absorb that surplus of gold of which the situation described has given them the command. In the former case American finance may possibly issue from its ordeal without a catastrophe; in the latter and more probable case, a terrible collapse will, in the end, be inevitable.

The foregoing remarks upon particular instances where the Foreign Exchanges offered

peculiar opportunities for analysis, are not intended to be historical or exhaustive, but only illustrative of the general question of interpretation which forms the special subject of the present chapter.

In the description of the American exchanges in 1861, it was proved that the omission of the most important element of value, namely, relative indebtedness, led in the first place to an erroneous interpretation of the perfectly natural efflux of bullion, and in the second to a mistaken estimate of its probable duration. In the course of the same exchanges during the two following years, it was the depreciation of the currency to which, while interpreting the remarkable fluctuations which have occurred, we mainly found we had to look. In both cases, indeed, it was seen that it was indispensable not to lose sight of other elements of value, while attributing the chief influence to one; but it is, above all, important that a real and fundamental cause should always be sought, and that it should not be supposed, as it sometimes is, that the action of speculators can more than modify, hasten, or retard natural causes.

INFERENCES FROM SPECIE EXPORT

For instance, when specie is being exported, it is sometimes supposed to be merely what is

called an exchange operation, undertaken by a certain class of speculators, whose business it is to make a profit out of the variations in the price of foreign bills at different moments, buying them when they are cheap and selling them at a profit, and sometimes sending bullion abroad to buy up bills on their own country, if the prices should be temporarily below or touching specie point. Gold will, of course, not be exported so long as these speculators in exchange, or cambists, as they are technically called, can procure short bills. They wish to place funds at a certain spot. As long as they can procure short bills in the quantities they desire—as long, that is to say, as there are sufficient foreign debts owing to their own country, payable immediately, which can be transferred to them, and which they can pass on to the others—they will not export gold. An efflux of gold accordingly proves, whoever the exporters may be, that the supply of short bills on other countries is being exhausted, that there is little more to claim at the moment from the country to which the bullion is dispatched, and that the balance of indebtedness is temporarily against the country from which the bullion is exported.

A further inference may be deducted from the foregoing remarks. It is often supposed that

gold is never exported unless to give a profit to those who dispatch it. But this is manifestly a fallacious idea.

The expression which is so often made use of, that the rates of exchange in any country are at such a point that no profit is to be made on shipments of gold to it, must be carefully guarded from leading to a misconception. Such a fact is valuable to know, to a certain degree; but it does not prove that the dispatch of bullion may not be natural and necessary nevertheless. It must be sent by those who are in debt to that country, if they cannot find bills. It is far more important to inquire, Is the balance of indebtedness discharged? The exchanges may remain exactly at specie point for a long time, offering no prospects of profits to any cambists, yet compelling the constant flow of bullion in order to discharge liabilities. It is indispensable to consider what debts have to be paid, before a judgment as to the drain of bullion can be formed. It is not so superfluous as many might believe, to dwell so frequently and so strongly upon this point, because, as a matter of fact, language is continually held, even among men who should be well versed in questions of this kind, which is practically at variance with the principles here put forth, though, in theory, they command immediate assent.

PROFITS ON EXCHANGE OPERATIONS

The question of profits on exchange operations can be reduced within very narrow limits. If carried beyond them, it only serves to obscure the plain operation of natural causes, without being essential to the real understanding of the subject.

Profits can habitually be realized by those who, when they observe that there is a prospect of the demand for bills exceeding the supply, purchase in anticipation, in order to sell at a higher price when the natural buyers, who require the bills for remittances, enter the market later on. And even when the exchanges reach the specie point, profits, though on a very limited scale, are made by those who, by having establishments identical with their own in foreign cities, and having a machinery specially organized for the purpose, are able by the avoidance of commission and the reduction of charges to make bullion shipments at a cheaper cost than the actual merchants or manufacturers who have the remittances to make. They dispatch the gold and sell the bills drawn against this gold to those who require to send funds abroad, realizing a fractional profit for the convenience which they afford. This, however, is in reality a matter of detail, and, as far as the exchanges and the principles which determine them are concerned,

it is perfectly indifferent whether the debtors to foreign countries—that is to say, importers, merchants, or consumers—remit gold themselves or pay a slight profit to cambists and bullion dealers, who, shipping it in large quantities, retail the bills drawn there-against to such as require to remit.

It is only in perfectly abnormal times that large profits are to be made on specie shipments, and only when the countries to which the shipments are made lie at a very considerable distance; so that those who have the sagacity to ship in time, or before others deem it necessary, have the advantage of being able to buy up bills below the specie point, owing to the urgent necessity of the sellers of the bills to receive the equivalent immediately; otherwise, it has been proved to be abundantly clear that the seller of such a bill—rather than allow such as have bullion on the spot by having shipped it in anticipation, to make a profit which would be his own loss—would send his bill to be encashed, and wait for the returns in specie himself. Where there can be immediate action and immediate communication, as between London and Paris, there can be scarcely any further profits upon shipments of gold beyond those which can be effected by an economy of charges. Only those who have a machinery for the purpose

can gain a profit which, in reality, is a kind of commission paid by the rest of the community. At a distance, there is much more margin; as, where months may elapse before bills can, by their natural process, be converted into coin, those who can undertake to give this coin on the spot can often make their own terms.

The limits are, therefore, clear enough within which the natural action of the exchanges may be checked or intensified by the operations of cambists. In the case of a gradual fall in the exchange in a distant country, where, if left to themselves, they might recede below specie point, because the unfortunate drawers of bills, being unable to wait the arrival of specie for their own account, might require their equivalent immediately, it might modify the position very much if speculators in foreign bills had foreseen the occurrence, and sent out specie to anticipate their wants, securing to themselves a moderate profit, but saving the drawers from a much heavier sacrifice. These are points which it is necessary to understand and appreciate, and which come into consideration in interpreting the exchanges of a given country at any given moment, but they can never impair the correctness of those elements of value which in principle determine the price of bills.

INFLUENCES OTHER THAN BALANCE OF INDEBTEDNESS

Of these it has repeatedly been pointed out that the balance of indebtedness, in its widest sense, is the most fundamental, entering in a greater or less degree into almost every case in which Foreign Exchanges are concerned. But the interpreter of the fluctuations in Foreign Exchanges will bear in mind that there are limits to the variations produced by this one particular cause. He will remember the peculiar features in the rates of exchange which would point to differences in currency, as distinguished from other disturbing causes. These will be remarkable for extending far beyond the limits within such fluctuations as are caused by excessive imports or exports, are ordinarily confined, and for being far more arbitrary and eccentric in their movements. So, too, he will not forget the influence of credit or discredit, and at any time of panic or other temporary derangement of confidence, the discount at which bills are sold will not be mistaken for the result of an adverse balance of trade or a depreciated currency. And, again, it will be borne in mind that sudden movements in the exchanges, either upwards or downwards, may reflect the position of the rate of interest in different countries, not only in the case of long dated bills, the variations in the

prices of which, when they differ from the variations of bills payable on demand, are regulated exclusively by the value of money and by credit; but also in the case of these bills on demand themselves, as indicating that a high or low rate of interest is causing certain movements of capital from one country to another.

The most general fact of which the exchanges are the sign is the degree of intensity to which the demand for bills on a foreign country exists, for whatever purpose this demand may arise; and it is clear that such a demand may be caused as much by a desire to remit a certain amount of capital to that country for the sake of employing it at a high rate of interest, as for the purpose of paying a debt. A high rate of interest attracts capital from abroad, and the effect of this attraction is immediately perceptible in the exchanges. By recalling the most elementary view of the transactions with which the exchanges are concerned, and by realizing the fact that foreign bills, to the prices of which so much importance is attached, are but the instruments by which payments are effected between different countries, it becomes clear at once that in the prices paid for such bills we may discern the strength of the current in which capital is setting towards one point or another, and that the effect of every influence

which may be brought to bear, to arrest or to hasten the force of this tide, will be registered with unerring certainty in the variations of the so-called "rates of exchange." Hence arises that intimate connection between the variations in the rate of interest, and the fluctuations in the Foreign Exchanges, which has long been recognized as one of the first principles to be kept in view in the study of monetary questions.

CHAPTER VI

REVIEW OF THE SO-CALLED CORRECTIVES OF THE FOREIGN EXCHANGES

In the last chapter we have been engaged in considering the subject of the interpretation of the Foreign Exchanges. The question now arises, how far the results obtained by such a study can be turned to practical account. In the same way as the phrase has become usual that the Foreign Exchanges are "favourable" or "unfavourable," so it has been the custom to say that the Foreign Exchanges might be "corrected." The accuracy of this phrase is just as open to question, inasmuch as it depends upon the view which is taken, whether what is termed correction is desirable or not. At all events, it must be borne in mind that that which is really to be corrected is not the actual position of the exchanges, but that state of things which has brought it about.

We have seen that it was a certain course of trade, or certain arrangements for payment, which caused the situation that was considered unfavourable *from a monetary point of view.* A modification of that course, or different arrangements for payment, might naturally be expected to operate in the contrary direction, and therefore it would seem as if it were possible, as soon

as a correct idea has been gained of the causes which have led to what is termed an unfavourable situation, to meet it either directly or indirectly, by a remedy, if a remedy is desired; in other words, to check the export of gold. This export of gold would, as we have seen, be the result either of the settlement of indebtedness, or of differences in the value of money, or of differences in currency. When it is attributable to this latter cause, the question of the correction of the Foreign Exchanges, unfavourable in this respect, namely, owing to a depreciated currency, widens into the consideration of the means which a currency once depreciated can be improved, and the equilibrium restored.

In the last chapter, the close connection of this subject with the Foreign Exchanges was illustrated at some length in the case of America; but we should travel beyond the scope of the present treatise, if, while discussing the so-called correctives of the Foreign Exchanges, we were to enter on the whole question of currency. It must suffice if we simply enumerate the restoration of a depreciated currency amongst such correctives, without entering further into the inquiry as to how this restoration can be effected. We shall confine ourselves to the discussion of those cases where the "unfavourable" situation is caused by circumstances connected with the

mutual indebtedness of two countries, or with the relative value of money in each, in other words, where fluctuations have been caused by some disturbance in the ordinary balance of trade, or by a rise or fall in the rate of interest.

These two influences will be generally found to be operating simultaneously in opposite directions. Money will be dear and scarce in the country which owes much to foreign creditors, and plentiful in that which has exported much; and, high interest will be attracting money to that quarter whence specie is flowing out in payment of foreign debts.

The adverse balance of trade will, as far as its power extends, render the bills on the country which is most in debt difficult of sale, and tend to compel it to export specie; whereas the high rate of interest, which is generally contemporaneous with a drain, or the prospect of a drain, of specie, will revive a demand for bills on this same country, and enhance their value in other quarters; for there will be a general desire to procure the means of remitting capital to that market where it commands the highest value. For instance, when in 1861 the excessive indebtedness of England to America (the result of her importations of cotton and corn) lowered the price of English bills in New York, and rendered specie remittances to the States

inevitable, the high rate of interest in England which this situation had brought about was so attractive to continental bankers, that they drove up the price of bills upon this country to specie point, and were finally induced even to resort to bullion remittances.

RESTORING EQUILIBRIUM WHEN ADVERSE EXCHANGES CAUSED BY BALANCE OF INDEBTEDNESS

From the foregoing, it seems to be evident that when the exchanges are manifestly against any country, and it is perceived that a balance of indebtedness is the cause, the equilibrium can be restored only in two ways: the one being the increase of exports and diminution of imports; the other, an advance in the rate of interest.

When the payments for imports continue for any length of time in excess of the receipts for exports, the redress of the balance can clearly only take place by ceasing to incur liabilities; that is to say, by a change in the course of trade. If a nation, taking advantage of unlimited credit, is importing and consuming more than it is exporting and earning, and accordingly runs into debt, it can escape from this position only by consuming less or producing more. If, however, the derangement is but temporary, and while it consumes more than it produces in the

first six months of the year, it exports more than it imports in the second six months, it can, like an individual with a prospective income, raise money to carry it over the interval. By offering a very high rate of interest, it will either be able to procure a prolongation of credit from its creditors, till in the natural course of things, by the subsequent increase of exports, the balance is paid off, or, it may induce third parties to make it a loan. Even in the case supposed above, where a country is actually spending beyond its means, and where, by borrowing, it can only increase the evil, as being thus enabled to keep the real danger out of sight for a time, a very high value of money is, in a certain sense, most desirable; as, by the action of the value of money on prices generally (according to the well-known principles which determine the relation between the two) a diminution of imports, and, consequently, of indebtedness, is likely to ensue.

OPERATION OF HIGH RATE OF INTEREST IN SUDDEN EMERGENCIES

But what we are at present most concerned to examine, is the operation of a high rate of interest in those more usual cases where we have to deal with temporary fluctuations and sudden emergencies, such as may be caused by

the loss of a harvest, or by a period of general national extravagance, ending in a critical inflation of prices, or by excessive warlike expenditure.

In such times, when the resources of a country are crippled for the moment, and its debts increased, it is most desirable—and indeed, absolutely indispensable—that not only bankers and merchants, but also the public at large, should clearly understand how quick and effectual a relief may be afforded by a high rate of interest, which is indeed the natural result of such a state of things.

Those who imagine that what they call an oppressive rate, adds to the losses and difficulties against which the trading part of the community have, at such periods, to contend, seem very much in error. For it is obvious enough in theory (and events have strikingly confirmed the theory in practice), that if apprehension is felt that the export of gold, which is resulting from any of the temporary emergencies just alluded to, is exceeding the amount which may conveniently be spared, and that the withdrawal of capital or currency which is taking place is likely to produce a scarcity which may render it difficult to conduct the business of the country on the ordinary footing, there can be no more effectual a remedy than to offer an inducement

to foreign countries to replace that which is being lost. An influx of capital is desired to take the place of that of which the country, owing to its exigences in another quarter, is likely to be deprived for a time; and this influx of capital is only to be procured by offering it the advantages of a high rate of interest—a rate, that is to say, higher than it can make at home, and sufficient to indemnify the capitalist for all the expenses involved in the transmission of his capital from one country to another.

Whether the inducement is powerful enough to effect its object will at once be apparent from the symptoms exhibited by the Foreign Exchanges. If the bills on the country where interest is high are in increased demand at advancing prices, an indication will be afforded that the attraction of the high rate is working its effect.

When the English public was anxiously watching the weekly shipments of gold to America, and was taught to look for consolation to the continental exchanges, which, let us suppose, were said to be taking a favourable turn, it was meant that the Continent sought with greater eagerness for English bills—a symptom that they were preparing remittances for the purpose of sending over funds to England, and that capital was passing from the Continent to us.

The more the price of bills advances, the nearer is the specie limit approached, till finally the remittances are made, not in bills, but in gold.

Practically the effect of the purchase of bills for the purpose of placing funds in England, is identical in its effect with a shipment of gold; for every English bill held by continental capitalists gives to its possessor the power of drawing gold from us.

It may be said that an advance in the rate of interest has been spoken of as if money could artificially be made dear. But the fact is, as has already been pointed out, that, where a considerable efflux of specie is taking place, the rate of interest will rise in the natural course of things. The abstraction caused by the bullion shipments will of itself tend to raise that rate; and banking establishments will in their own interest (which will be identical with the interest of the public) accelerate this result as far as lies in their power.

It would encumber the course of the argument to enter at this stage on the discussion as to whether it is capital or money which is rendered scarce by the exportation of bullion, and which can be attracted by a high rate of interest. Whichever be the case, the opportunity given by higher rates of interest for advantageous employment will be seized. A country which is

paying off its debts, is sending away a portion of its capital when it exports specie; and the foreign bankers who send over gold in order to buy up English bills, are supplying us with capital for a time, to take its place. At the same time, the actual export of bullion is a loss to the money of the country, and the import of gold from abroad replaces that which has thus been lost. In both cases, that which will effectually bring the gold from abroad, in the most general and practical sense, will be the opportunities offered by a high rate of interest, to effect profitable and attractive investments.

INFERENCE FROM CHANGE IN BANK RATE

The efficacy of that corrective of so-called unfavourable exchanges, on which we have been dilating, has been most thoroughly tested since the Bank of England has adopted the system of varying its minimum rate of discount more rapidly and more extensively than was its practice in former years. Not that it is to be supposed that the Bank of England itself can make money dear or cheap. Before the Act of 1844 was passed, when the Bank had the privilege of an unlimited issue, its influence over the money-market was certainly very great. But now that its resources are as strictly limited as

those of any other establishment, its power to make money dear or cheap does not extend beyond its own stock of notes; and by lending them to the public at a cheaper rate than the demand for discount warranted, it could only keep down the price of money for a few days or weeks.

The real importance of a variation in the minimum rate of the Bank does not consist in the power exercised over, but in the indications afforded, the money-market. The fixity of the minimum rate has this effect, that practically it becomes a maximum to the public. Persons in good credit are almost always able to procure money a fraction under the Bank rate, and consequently the Bank of England is generally the last to feel the pressure of a rising demand. Thus, an advance in the Bank rate generally means that a previous pressure had been put on all other sources where discount is obtainable, and that the demand has reached the last reserve. Sometimes the Bank may raise its rate from internal causes, or from apprehension, but the general inference from such an advance is that which we have sketched. For this reason foreign capitalists rightly attach great importance to the variations of the Bank of England minimum, regarding them correctly rather as indications of the changing value of money

than as the results of an attempt to control its price.

The fact has been that almost every advance in the Bank rate of discount is followed by a turn of the exchanges in favour of England; and, *vice versa,* as soon as the rate of interest is lowered, the exchanges become less favourable; — that is to say, in the first case, there is an indication of a demand for bills on England, as a means of placing capital here, to take advantage of the ruling rate; in the second case, there comes the reaction, that is to say, there is a demand here for bills drawn upon foreign cities, in order to send this money back; or, what comes to the same, in the first instance there are few buyers here for bills on foreign capitals, because foreign creditors give their English debtors a respite, and prefer to wait longer for remittances, gaining interest meanwhile at the profitable English rate; in the second, when this rate is lowered, the foreign creditors find that they have no longer any advantage in leaving their claims upon us open, and require pending accounts to be closed.

The general effect of a high rate of interest in attracting capital, and its consequent action upon the Foreign Exchanges, may easily be understood and appreciated, even by those who are not conversant with the details of banking

business; but a further effect of the same cause is of a more technical nature.

INTEREST FROM LONG-DATED BILLS

It will be remembered, that of the aggregate indebtedness of any country a large portion is generally embodied in bills of exchange which have some time to run. Now, these bills seldom remain in the hands of the drawers, but are partly used as immediate remittances to the country where the bills are payable, and partly are bought by bankers or capitalists who desire them as an investment of money, yielding a certain interest during the interval between the date of their issue and the date when they fall due. This interest lies in the cheaper price of the bills.

A bill drawn payable three months after date is bought by a banker at a price which is equal to a bill payable on demand less three months' interest, and this interest will not be that of the country where the bills is drawn, but that of the place where the bill is payable: for the purchaser will have to discount the bill in the foreign country at the rate there ruling, before he can make it equally available with a draft on demand; and the drawer can suffer this deduction from the price of the bill at the same rate without loss, as, giving the foreign acceptor

three months' grace before payment, he will receive from him the same amount of interest until the debt is discharged by the actual payment of the bill, as he loses in the price of the bill itself.

Accordingly, when foreign bills are bought as an investment, it is with the view of earning the higher rate of a foreign country, in the place of the lower rate ruling at home; a circumstance which it is most important constantly to remember, as the tendency described may be relied on as always in operation when the rate of interest is peculiarly high in any country, the credit of which is unimpeached.

As a matter of fact, the interest which can be secured by what we may call the speculative purchasers of bills, generally lies between the rate of the country where the bill is purchased, and the rate of that on which it is drawn, as competition enables the seller to secure a portion of this species of profit. If the rate in Germany is 3 per cent, and the rate in England is 5 per cent, those who have three months' bills on England will not be obliged to submit to a discount of 5 per cent, which, according to first principles, should be deducted. Many will be found who, in order themselves to make 1 per cent more than the highest rate which they can secure at home, will not claim to deduct more than 4 per cent

from the price which they would pay for a bill on demand, instead of the 5 per cent which would seem the natural rate.

It should be observed that these greater or lesser deductions are generally expressed, not in the rate of interest, which is to be deducted, but in the price of the bill—the bill is so much cheaper or dearer: but it is expedient to consider the case in what we may call its original form, in order the more clearly to discern the force of the rate of interest.

BILL HOLDINGS OF BANKS AND EXCHANGE DEALERS

We now come to the fact, which it is also very important clearly to appreciate, that at any moment there is in the hands of bankers and exchange-dealers a large amount of bills on various countries, held partly for the purpose of speculating on a rise or fall in the price of bills, but, to a very large extent, solely for the sake of the interest which is to be made on them. Bills on England, owing to the high rate of interest which they often bear, as compared with continental rates, are a favourite investment abroad. In Paris, Berlin, Frankfort, Hamburg, and other continental cities, the bills on England held by the bankers and joint-stock companies often amount to many millions sterling; and

a very large sum remains in their hands for several months—in fact, from the time when the bills are drawn to the time when they fall due.

The immense importance of this circumstance cannot be overlooked.

If at any time the rate of interest here falls below that which rules on the Continent, it is inevitable that the whole mass of these bills will at once be sent to London, and be discounted there at the cheaper rate, so that the proceeds may be remitted in gold to the Continent to be invested there in local securities at the supposed higher rate. On the other hand, so long as the discount in London is higher than that which can be obtained abroad, so long the foreign bankers will be induced to hold their bills till they become due. The debt, it will be remembered, which is embodied in the bills in question, and without which they could not exist, must be paid sooner or later; but the time when it must be liquidated will, within certain limits, depend upon the rate of interest. If it be high, the bills will be allowed to run off abroad, and the gold will not be exported till the last moment; if it be low, there is the possibility of the whole mass of bills being sent to England for discount as soon as they are drawn, and the gold being exported at once instead of three months afterwards.

Accordingly, if, to take a practical instance, specie is being exported from England to America, an advance in the rate of discount is an inducement to foreign capitalists to hold back their bills upon England to the last moment, as well as to make remittances hither to invest the proceeds at the high rate: both circumstances cause a demand for these bills abroad, and their price must rise. At the same time, a proportionate fall in the price of foreign bills will occur. For, a convenient mode of placing funds in England being to instruct English firms to draw on foreign bankers, these bills are likely to be pressed on the market; whereas, owing to the assumed desire rather to leave capital in England than to call it in, there will be few purchasers for them, and their price must decline. (The rise of bills on England abroad is always identical with the fall of the prices of foreign bills in England; for there are two ways of settling every international transaction: either the creditor draws a bill on the debtor, or the debtor remits a bill to the creditor; and accordingly, the same circumstances which make it difficult to the creditor to sell his bill to advantage, will make it difficult for the debtor to purchase the necessary remittance to advantage. When bills on England decrease in value abroad, bills on the Continent increase in value on the

London exchange; and when, as in the case where a high interest is setting the current of capital towards England, there is a great demand at high prices, for bills upon London, there is a corresponding absence of demand and low prices in England for bills on foreign cities.)

WHY INTEREST DIFFERENCES EXIST

After the preceding observations, it may well be inquired—How is it possible that, in spite of the rapid flow of capital from one country to another to fill up any gaps that may have been left, such a difference in the rates of interest can exist between two countries as has occasionally been witnessed for some time in the case of England and the Continent? How, it may be asked, is it to be explained that the rate of interest could at one time remain at 6 per cent in London, and at 2 or 3 per cent in Hamburg and other continental cities? This is a mystery which has puzzled many during several periods when our rate of interest has so much exceeded that of the Continent. It is a question, however, which can be solved with the greatest ease.

In the case of Hamburg, we have to deal with the facts that there exists a difference of currency. The capitalists of Hamburg, who have, by the hypothesis, so much money to spare that they can only manage to obtain 2 per cent

interest for it, possess this money in silver, and accordingly, the possibility of their sending this surplus money over to England will depend upon the probability of the silver being sold to advantage.

The natural process will be to ship the silver to England, to sell it there at what it will fetch, and with the proceeds to discount bills at the high rate current in England. When these bills, however, mature, and the Hamburg banker wishes to re-possess himself of the money, he will have to change the sovereigns, in which the English bill is paid, back again into silver, possibly paying a premium for it; and this silver he will have to re-ship to Hamburg.

This is the complete theoretical process. He remits his silver, invests its equivalent for a time in bills payable in gold, and re-ships silver to Hamburg when the bills mature.

Accordingly, when he strikes his balance at the end of his operation, he will find, in the first place, in his favour, the difference between the Hamburg and the English rate, which we have supposed to be as great as 4 per cent. This difference, however, if we suppose him to have invested his money in three months' bills, he will have enjoyed for only a quarter of a year, and thus his apparent profit will so far be 1 per cent. But out of this 1 per cent he may, under

favourable circumstances, have to pay the expense of specie remittances to and fro: first on sending his silver to England, and then on its return; and further, he may lose, and have to sacrifice, a difference between the price at which he sold his silver on its arrival in England, and that at which he bought back a similar quantity of the same metal when he required his capital again at home.

It is easy to perceive that it is exceedingly possible that these expenses on the transmission of bullion and the loss on the silver may far exceed the 1 per cent which he is supposed to have gained; and accordingly it is quite natural and intelligible that, under certain combinations of circumstances, even a difference of as much as 4 per cent may exist between our rate of discount and that in Hamburg, without their surplus capital finding its way to our money-market. At the same time, it will readily be conceded that there is a point at which the difference becomes so great that the chances of loss and expense are more than covered by the increase of the interest, particularly if the high rate can be secured for six-month instead of three-month bills. During most periods of high discount on this side of the Channel, there have been large orders here to take six-month bills for foreign bankers; and clearly the preference is

given to the longer paper, because the attractive rate being secured for so much longer a time, while the probable cost of bullion remittances and risks of loss upon silver remain the same, the chances of profit are almost doubled, or at least a larger margin is at once secured for provision against the risks which are run.

The instance of Hamburg, with its silver currency, offers a peculiarly convincing illustration of the difficulties attending the transmission of capital from one country to another; and, at the same time, of the advantage of a rate of interest sufficiently high to overcome these difficulties, whenever it becomes desirable that foreign bankers should come to the relief of our money-market. However, even when they both have an identical currency, it is easy to explain the possibility of two very different rates of interest existing simultaneously in two countries.

The point to be looked to is the cost of the transmission of bullion to and fro; and, according to the distance of the two countries, so will it be possible for differences in the rate of interest to exist in a greater or less degree.

THE RATE INCREASE NECESSARY TO BRING GOLD

Between the rates in London and Paris, the expense of sending gold to and fro having been

reduced to a minimum between the two cities, the difference can never be very great; but it must not be forgotten that—the interest being taken at a percentage calculated per annum, and the probable profit having, when an operation in three-month bills is contemplated, to be divided by four, whereas the percentage of expense has to be wholly borne by the one transaction—a very slight expense becomes a great impediment. If the cost is only ½ per cent, there must be a profit of 2 per cent per annum in the rate of interest, or ½ per cent on three months, before any advantage commences; and thus, supposing that Paris capitalists calculate that they may send their gold over to England for ½ per cent expense, and chance their being so favoured by the exchanges as to be able to draw it back without any cost at all, there must nevertheless be an excess of more than 2 per cent in the London rate of interest over that in Paris, before the operation of sending gold over from France, merely for the sake of the higher interest, will pay.

This is the simple explanation why a slight increase in the rate of discount is, under some circumstances—that is to say, when there is not a great supply of bills upon England—not sufficient to bring over gold from the Continent. It must reach a somewhat high point before the

certain advantage begins; and hence it becomes clear that it is an error to allege that, if 6 per cent will not bring over gold, neither will 7 or 8 per cent, a mere fractional increase in any annual rate, have that effect.

Yet on one occasion, when the Bank rate of discount was advanced to 8 per cent, the question was frequently asked—Is it likely that, if 7 per cent failed to bring over the gold, such a result will be attained by charging 1 per cent more?

The preceding observations place the matter, it is hoped, in a sufficiently intelligible light. The first few per cents do little more than cover the possible expenses of the transmission of the bullion itself, a difference of 4 per cent per annum on three-month bills being necessary to cover 1 per cent expense: but as soon as the charges (or the risk of charges) which are really almost identical with what is usually called the loss in exchange, are covered, then every additional per cent which is granted as discount becomes an actual and certain profit; and, accordingly, if gold is required, the rate of discount must be advanced till that point is reached. To stop short of it may, under some circumstances, be nugatory.

In practice—owing to the fact that the supply of bills upon England seems to be almost

inexhaustible—the operations will take a somewhat different form from that which we have just examined, but the tendency will be admitted to be identical.

When the English rate of interest advances, there will be a general desire on the Continent to take advantage of this circumstance, and to remit capital to England for temporary advantageous investment; but how is the transmission to England to be effected? Of course in bills, so long as they can be procured; and consequently those who are holders of bills on England, and are willing to sell them, find themselves in possession of an article which is suddenly in great demand, and are thus enabled to make a higher price. Competition raises this price, till remittances by means of bills become almost as expensive as a shipment of bullion itself; and thus the profit, which would be made by those who could buy bills at the usual exchange to remit to England for investment at the higher rate, is divided between those who sell the bill and those who buy and remit it. To the latter, when the demand is strong, the bill may finally become as expensive as bullion shipments themselves; and as the supply of bills tends to become insufficient, gold is actually sent. This is the technical explanation of the rapid rise of the price of bills on any country as

soon as any advance in the general rate of interest obtainable there takes place.

It is a rise caused by the competition for the most ready and most convenient vehicle for the transmission of capital, the competition itself being the result of a high rate of interest.

A fall of the rate will cause a corresponding fall in the prices of bills; and, acting as it does with invariable force, and being succeeded by invariable results, it is clear that there is no corrective of a drain of gold, and all its attendant consequences, more powerful and effectual than a rapid advance in the rates of discount. It is the only mode by which that which is on the point of being lost may be retained, or that which is actually gone may be replaced; and its natural effect is, not to produce a scarcity of money, of which it can never be the cause, though often the consequence, but to remedy and correct this scarcity by offering a premium to the rest of the world to send their capital or money to the dearest market.

EFFECT OF BILLS WHICH DO NOT REPRESENT INDEBTEDNESS

We should here allude once more to the function of those peculiar foreign bills of which mention has previously been made, which, not representing any actual indebtedness, do not

become amendable to the laws which regulate that indebtedness, but on the contrary, rather influence the exchanges in an opposite direction.

When the indebtedness of one country to another is almost settled—that is to say, when almost all the bills between them are drawn, remitted and paid—it is the natural result of this situation that the price of the few remaining bills should become exceedingly high.

On the other hand, the issue of bills representing no transaction in goods, but simply based upon credit, and consequently (but for the knowledge that they must subsequently be provided for) illimitable, operates in the contrary direction; that is to say, tends to depress the price of bills.

Thus, there are times when, for the period during which the bills have to run (for, as soon as they have to be covered, their previous effect is neutralized at once), their issue may have a material effect upon the export of gold. Those who draw bills in this manner on credit, may be actuated by two different motives: either they may wish to secure the use of the money paid as the price of the bills, for legitimate or illegitimate purposes, during the two months which the bill has to run, that is to say, till the time when they must against part with the money in order to buy remittances—or they believe that when

their drafts come to maturity there will be a larger supply of bills on the market, and that then they will be able to make a profit by buying their remittances at a cheaper price than they obtained for their drafts.

The issue of drafts drawn upon credit, and not against any debt—that is to say, drafts by which the drawer incurs a debt, instead of securing to himself the payment of a debt of another—is a measure by which the merchants of the country in which they are drawn may be temporarily relieved of the necessity of making bullion remittances, if they are in debt, or be enabled to make cheaper remittances if they want to give orders. And they are useful enough when they bridge over an interval which may exist between the seasons of exports and imports, as in that case they may save the double transmission of bullion.

But in other cases the issue of such bills is likely to be attended with dangerous consequences, as, though giving relief for the moment, by supplying that which is in great demand, and which cannot otherwise be got—at the expiration of a certain time it will add to the difficulty, as an equal amount must again be withdrawn.

On the Continent, this species of bills is often used as an engine for drawing gold from England; in fact, as a mode of borrowing in the London

market. Drafts are issued, payable three months after date; these are remitted to London, and there discounted, the proceeds being invested in gold, and shipped abroad. When the exchanges are unfavourable to the Continent—that is to say, when a bill on England commands a larger number of dollars or florins than usual—such bills create an artificial supply, and may prevent the price from running up to specie point.

It is scarcely desirable to enter into further details as to the various artificial means and banking manœuvres by which those who speculate in the exchanges—that is to say, on the rise and fall of the prices for foreign bills—manage to influence or counteract what may be called the natural fluctuations. It is only necessary to point to the existence of such speculations and their attendant circumstances, as otherwise errors might be committed through the confusion of temporary and artificial fluctuations with the natural and inevitable consequences of regular and definable laws.

CONCLUDING REMARKS

The object of the present treatise has been to unravel a few of the most important first principles at which we may arrive in the study of the Foreign Exchanges; and especially to exhibit, as clearly as possible, the origin and natural

explanation of transactions which, in their more complicated form, appear too technical and confused to be easily appreciated by the general public. In these first principles there is in reality nothing difficult or abtruse. The difficulty lies, not in the apprehension of them, when they are plainly and popularly stated (they then seem almost a matter of course), but in the stating of these principles in sufficiently plain and popular language.

Thus, if the perusal of the preceding pages leaves the reader more confused as to the Foreign Exchanges than he was before, he must by no means believe that he has been engaged upon a subject which is too technical or too difficult, too little amenable to the usual method of scientific inquiry, or too complicated by a perpetually shifting mass of practical details, for any satisfactory result to be obtained. He must rather believe that the author is in fault through his inability to convey clearly to the reader's mind that which to himself seems patent enough, and through his not possessing sufficient mastery of language to be able to dispense entirely with the jargon of the money-market and the exchange.

The Foreign Exchanges are pre-eminently a subject which requires less controversial discussion than a careful and thorough analysis.

The main principles which have been advanced as to the origin of exchange operations, as to the groundwork of international indebtedness, as to the various classes of foreign bills, as to the different causes which regulate the fluctuations in their price, and as to the conclusions which may be drawn from these fluctuations, are rather statements of self-evident though somewhat complex truths, than matters for controversy, while only that branch of the inquiry which treats of the correctives of unfavourable exchanges can legitimately form a battle-field for discussion. For any subject to be satisfactorily argued, and for the value which attaches to conflicting theories upon it to be fairly appreciated, it is above all things necessary that it should be clearly understood; and the object of the present essay will have been fully attained if it proves in any way instrumental in promoting clearer and more positive ideas as to the most general principles and rudimentary facts which present themselves in any inquiry into the laws of the "Foreign Exchanges."

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